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AIRLINE DEREGULATION ACT OF 1978

HEARINGS

BEFORE THE

SUBCOMMITTEE ON AVIATION

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

OVERSIGHT OF THE AIRLINE DEREGULATION ACT OF 1978

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AIRLINE DEREGULATION ACT OF 1978

MONDAY, JUNE 27, 1983

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON AVIATION,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room SR-253, Hon. Nancy L. Kassebaum (chairman of the subcommittee) presiding.

Staff members assigned to these hearings: Kathy L. Meier, staff counsel; and Steve Palmer, minority staff counsel.

OPENING STATEMENT BY SENATOR KASSEBAUM

Senator KASSEBAUM. Good morning. We will go ahead and start the hearing. I was just visiting ahead with some of the panelists regretting that perhaps we don't give more thought to combining hearings with the House when we are taking joint ventures such as this because it only means that those of you who are testifying have either already gone through the same testimony on the House side that you will be doing here, or if we have the hearings first over here then going over to the House side. I think in some areas it would benefit us to work together.

The scope of this hearing this morning is on oversight review of the Airline Deregulation Act. Certainly there are many issues to be raised in studying that issue.

Many customers and consumers out in the country wonder if it is working as it should, and that is what we hope to explore through the hearings this morning and tomorrow morning. Outside the scope of this hearing are the issues associated with the labor protection provisions of the ADA and the CAB's decision in the competitive marketing investigation. These will be covered later as will the sunset of the Civil Aeronautics Board.

Senator Hollings has an opening statement which will be placed in the record at this point

OPENING STATEMENT BY SENATOR HOLLINGS

I am pleased that the Aviation Subcommittee is holding two days of oversight hearings on airline deregulation, reviewing its effect on the airline industry as well as the air traveler. As a frequent user of our air transportation network, who knows the importance of timely service to a wide variety of locations, both large and small, I can appreciate the value of such a review. I therefore commend the Chairman and Ranking Democrat of the Subcommittee for holding such timely hearings.

While I supported the Airline Deregulation Act in 1978, I have had an opportunity to re-evaluate my thinking on this issue. In the intervening years, I have devel-

oped serious reservations about the beneficial value of deregulation for consumers, because of reductions in service for many communities, as well as increased fares. Now, however, in light of operating losses totalling some $733 million for the industry in 1982, not to mention losses of $567 million in the first three months of 1983 alone, I am beginning to question the effect it may be having on the long-term viability of the industry itself.

Apart from this concern for the solvency of the airlines and the future capablilities of the air transportation system, I am deeply troubled with how deregulation has affected service to smaller, less-well traveled communities. Much has been written and said about the $99 discount transcontinental fare. However, very little attention is given to the fact that in the smaller non-hub communities, service has declined significantly since 1978. This naturally concerns me, for without ensuring adequate service to communities like Charleston, West Virginia, deregulation will likely be deemed a failure.

I hope the Subcommitee will also give serious consideration to the impact deregulation has had on airline safety. Much has been said about how the huge losses being incurred by the airlines have encouraged a decreased emphasis on maintenance and air safety. While it is my sincere hope that this is not the case, I hope the issue will be thoroughly explored during these hearings.

Our responsibility in the Federal Government remains the need to assure the availability of a safe, reasonably-priced air transportation system to all Americans. These hearings are the first step toward gathering the information available on deregulation in order that we can accomplish that goal.

Senator KASSEBAUM. It is a pleasure for me to welcome this morning the first panel, Mr. Frank Willis, Deputy Assistant Secretary for Policy and International Affairs, Department of Transportation; Mr. Dan McKinnon, Chairman of the Civil Aeronautics Board; and Mr. Paul Ignatius, president of the Air Transport Association.

Mr. Willis, would you like to lead off?

STATEMENT OF FRANK WILLIS, DEPUTY ASSISTANT SECRETARY FOR POLICY AND INTERNATIONAL AFFAIRS, DEPARTMENT OF TRANSPORTATION

Mr. WILLIS. Thank you, Senator. It is a pleasure to be here on behalf of the Department of Transportation to appear before the Subcommittee on Aviation of the Senate Commerce Committee to talk about what is happening under the Aviation Deregulation Act of 1978.

With your permission I will submit my written statement for the record and summarize the main points.

Senator KASSEBAUM. Your statement will be printed in the record.

Mr. WILLIS. As indicated in my written testimony there is no question that the U.S. commercial airline industry has weathered some trying times since enactment of the Airline Deregulation Act. Their record operating losses in 1982 have given us all and of course particularly airline management cause for concern.

But it is our judgment that the factors which contributed to these losses—the recession, rising fuel costs, high interest rates, and the air traffic controllers' strike—are beginning to reverse and that the industry is moving toward profitability. As an example we have noted that airline traffic for May is up more than 6 percent over last year, and we believe the industry is also optimistic. A week ago the Air Transport Association's top economist predicted that the industry will earn an operating profit of between $850 million to $1.5 billion during the final 9 months of this year.

When assessing the actual results of pioneering legislation—and that is what the Airline Deregulation Act was, a pioneering effort by Government to reduce interference in a naturally competitive industry—it is necessary to separate the effects of extraneous factors from those which are at the heart of whether the concept in and of itself is good or bad.

We believe that air transportation deregulation is a good idea.

It has given the industry and the public a variety of opportunities for safe and efficient service that simply would not have been there if Government was still tightly controlling entry, exit, and prices. Since 1978 there has been an increase of 62 CAB certificated carriers—22 of which are brand new companies. So airline deregulation has presented tremendous opportunities for the formation of new companies that's in contrast, by the way, to the situation in October 1978 when Midway Airlines was the first totally new company to be granted a CAB certificate in 38 years.

There have been some carrier failures—Altair, Braniff, Golden West—and we are troubled by those failures, but we believe that overall the system has been strengthened by vigorous competition and even in the bleakest circumstances, such as Braniff we see some hope. We have taken a look in the Department at the arrangement being discussed to reconstitute Braniff, and although a final determination cannot be made until Braniff and Hyatt submit their agreement to the bankruptcy court, it appears that the current proposal is consistent with our rulemaking on returning slots to a reorganized company.

The trend for the formation of new airlines is continuing. In the Aviation Daily a couple of weeks ago I noticed on one page reports of no less than four new airlines proposing to provide service, and since that time we have read reports of another carrier proposing to institute service hubbing at Phoenix and another new airline making a proposal to hub out of Seattle. These carriers believe they have discovered a niche in the marketplace, and that is what we think deregulation is all about, businessmen exploring the marketplace finding out what works and having the flexibility to create or modify operations as the marketplace dictates.

The result of all of this activity since 1978 has been an increased competitive environment with positive effects on service, efficiency, and fares. The new opportunities presented have helped balance out the employment disruptions that some of the major carriers have experienced.

Employment figures show that between 1978 and 1982 overall employment in the industry has experienced only a modest change, a decline of 3,000 full-time positions—from 321,000 to 318,000 jobs—based on a comparison of year-to-year October data, and this small decline took place when employment levels in other industries were dramatically declining.

We think even this small decline may see a reversal as new carriers take to the skies and as the Braniff proposal moves forward also. We do not want to minimize the fact that some people have lost their jobs, but the fact is we believe that if there had been a restricted entry under the old system of regulation even more airline employees would be out of work and unable to find opportunities in the industry.

We believe there is supporting evidence for the success of deregulation in other aspects of the industry. We believe that there have been improvements in productivity forced through the rigors of competition.

In the last 10 years according to the Air Transport Association statistics available, seat miles per employee jumped over 11 percent. The average number of revenue passenger miles produced per gallon of fuel rose from over 20 to above 25 and average load factors have increased from the days when tight economic regulation held them at 55 percent.

These improvements in productivity have meant that the airline industry has kept average fares at reasonable levels despite enormous increases in the prices of goods and services it needs for operations. With the pricing flexibility dictated by the Airline Deregulation Act, airlines have responded with a large number of fare opportunities, and we find now that some 80 percent of passengers travel on discount fares, as compared to 48 percent travelling on discount fares in 1978.

In conclusion, we believe that airline deregulation has given the public a broader range of choices and services and prices, and it has expanded business opportunities, promoted employment opportunities and stimulated efficiency in the industry as a whole. We think there is a compelling case for deregulation being made in the marketplace, and the best evidence we can present for that is that there is no cry in the commercial airline industry nor among its users for a return to extensive Government control.

Secretary Dole has asked me to convey to the committee her strong and personal commitment to airline deregulation. We believe there should be no turning back.

Thank you.

[The statement follows:]

STATEMENT OF FRANKLIN K. WILLIS, DEPUTY ASSISTANT SECRETARY FOR POLICY AND INTERNATIONAL AFFAIRS, DEPARTMENT OF TRANSPORTATION

Chairman Kassebaum and Members of the Subcommittee:

I am pleased to be here today to present the Department of Transportation's assessment of the aviation industry under deregulation. I will discuss several important aspects of airline deregulation—industry financial performance, fares, airline costs, the structure of the industry, service to cities of all sizes, employment, and the needs of the travelling public.

Let me begin with the bad news about the industry's performance. For a number of reasons—rising fuel prices, the recession, the air traffic controllers' strike—the air carrier industry is just now emerging from what has surely been its most difficult financial period. The airlines have suffered three consecutive years of operating losses. Overall industry losses in 1982 were the worst in history, approaching $800 million—and would have been much larger were it not for the sale of tax benefits.

There was, as might be expected, a considerable range of experience among the individual companies. As a group, the largest air carriers—the majors—suffered most. Among the eleven largest carriers, only one was solidly profitable in 1982. While most of the national carrieres remained profitable in 1982, earnings slipped from the record levels of 1981 and some experienced serious losses. Among new entrant carriers, most failed to reach profitability by 1982; however, early losses are normally to be expected in any new enterprise.

As a result of the losses of the past three years, several major carriers and national carriers are having severe financial problems. Some, including Braniff and Altair, went bankrupt.

How many of these financial problems should we attribute to deregulation? I believe almost none. As the carriers themselves and almost every industry analyst will tell you, the root of the problem has been the economy, not airline deregula-

tion. We are just now coming out of the longest economic downturn since the Depression and certainly the least favorable economic climate the modern airline industry has ever faced. Traditionally, airlines make a lot of money when the economy is prospering, and lose a lot when the economy is bad. The weak economy caused business to cut back on travel at the same time that consumers reduced vacation trips. The result was serious overcapacity throughout much of the airline industry. Rather than ground their equipment, on which they had to bear fixed costs anyway, carriers decided to introduce discount and promotional air fares to retain or increase ridership. These discount fares undoubedly stimulated some additional travel. Nevertheless there was an absolute year-to-year decline in revenues in 1982—a first for the majors—despite a 3.4 percent increase in traffic.

High interest rates and inflation also contributed to poor industry performance. Interest rates skyrocketed at a time when many carriers needed to replace equipment with more fuel-efficient planes. Carriers that were committed to replacement paid a stiff price when they became locked into high interest rates. Other carriers which had put off capital investment were forced to continue operating less fuel-efficient aircraft. Some carriers had labor contracts with built-in wage escalators which, during the high inflation of the late 70's, caused labor costs to rise rapidly.

Two other factors added to carrier problems since 1978. Drastic increases in fuel prices in 1979 had carriers scrambling to realign routes, or replace fuel-inefficient aircraft, or adjust fares to cover higher costs. On top of all this, and in the midst of efforts to restructure routes, the industry was forced to adjust to scheduling constraints brought on by the air traffic controller strike in 1981.

Given the combined impact of these factors, it is a tribute to the industry—management and labor both—that the necessary adjustments were made and that the long-term outlook for the industry is healthy. Airlines simply could not have made these adjustments without the flexibility provided by deregulation. Even the best-intentioned government regulators could not have responded as promptly and effectively to these shocks to the system as the airlines did themselves. Had the industry still been regulated, needed route realignments would have been delayed, as would speedy adjustments in fare structures. Instead, airlines were able to respond quickly to the opportunity to create more efficient networks, and competition for travellers and shippers has given consumers a wide variety of discount fares at the same time.

We believe the financial prospects of the air carrier industry are improving, for several reasons. Fuel costs have declined, the economy is improving, traffic appears to be rebounding, and overall costs hopefully have stabilized now that we have inflation under control. 1983 will still be a tough year financially for the carriers. Nonetheless, with continuing improvements in the economy, I think we will have turned the corner on a very difficult period for the airlines.

The major changes in industry structure since deregulation have been the growth of the nationals and regionals and the entry of new carriers. Some of this growth came at the expense of the former trunk carriers. Although they retain a major share of the market, the former trunks' share of domestic revenue passenger miles has fallen from about 87 percent of the total domestic revenue passenger miles in 1978 to around 80 percent last year.

New entrants have been successful in carving out markets for themselves, partly by replacing service dropped by existing carriers and partly by stimulating new air travel. In the first three years after the passage of the 1978 Act, the market share of new entrant airlines rose from 3.6 to 7.7 percent. The primary spur for this structural change has been their lower fares, which are made possible by lower costs and greater efficiency. New entrants generally have significantly lower operating costs than carriers which were operating prior to 1978. This is due to lower wage scales, more flexible work rules, and the lack of various other pre-existing restrictions which hamper pre-deregulation carriers. Thus, they have stimulated travel through aggressive and innovative pricing approaches.

Regional and commuter carriers have also grown since deregulation. This growth continued even during the recent downturn in the economy. Regional/commuter passenger traffic grew by 20 percent last year; revenue passenger miles by 26 percent; and air cargo by 11 percent.

With respect to employment, all the factors which I mentioned earlier—rising fuel prices, the recession, and the air traffic conrollers' strike—have had their effect on the airlines' workforce. Nonetheless, between October 1978 and October 1982, overall industry employment hardly changed, showing a slight decline of 3,000 full-time jobs from a level of 321,600 to 318,300. Within these overall aggregates, however, there were some significant shifts in the location of jobs among the various sectors of the industry and individual carriers as the industry moved to adapt to the depressed economy and the new competitive environment brought about by deregu-

lation. For example, in the four years between October 1978 and October 1982 employment among the eleven majors declined by about 24,000 while the smaller national and regional carriers increased their full-time jobs by some 21,000. Although it seems clear to me that the strongest influence on industry employment during this period has been the weak demand that accompanied the recession, the truly significant thing is that the industry under deregulation has been able to respond and adapt, thereby sustaining employment levels in the face of that recession.

Airline unions have testified before the House of Representatives Subcommittee on Aviation that such aggregate numbers do not tell the full story in terms of shifts in the location of jobs as well as in long term declines in employment among some of the more troubled of the majors. There is substance to this observation. Any industry undergoing structural change experiences disruptions among both union and management employees. It is the Department's belief that the downturn in the business climate has had the most significant influence over total airline employment levels, not the Deregulation Act. In addition, although there have been some disruptions in the airline workforce, the present average compensation for the airline employee is 70 percent higher than the average compensation in other U.S. industries.

Deregulation is having a significant impact on costs and productivity, although much of this impact is masked by economic conditions. There have been five areas in which deregulation has introduced opportunities for increased efficiency and, thereby, lower costs. First, deregulation permitted carriers to improve equipment utilization by realigning routes and rescheduling flights. Second, by realigning routes, carriers have been able to improve load factors, thereby reducing the average cost per passenger. Third, under regulation fares were generally kept high and carriers competed by offering high quality service—often a more costly service than passengers wanted to pay for; with deregulation, carriers adjusted services to meet market demand, thereby lowering costs. Fourth, new carriers entered the business with significantly lower costs, in some cases offering "no-frills" service and in other cases offering standard service at lower fares. Fifth, as a result of the competition, labor and management cooperated to improve productivity and efficiency.

Carriers have also instituted major changes in their pricing policy. Some have adopted a wide variety of restricted discounts, while others have charged unrestricted low fares. Some carriers have expanded off-peak discounts, charging lower fares during times of low demand. The effect of these pricing changes has been beneficial for industry productivity, as discounts have helped bolster lagging demand and improve load factors overall, while off-peak pricing differentials have helped to balance out loads throughout the day and the week. With more balanced passenger loads, carriers have been able to achieve better utilization of both equipment and labor. Equally as important as the effect on productivity, this change in pricing practices has given consumers a far wider choice in fares—particularly low fares—than they had under regulation.

Of course this period has also seen the development of "fare wars," particularly deep discount pricing in the high density transcontinental markets, which may have contributed to the industry's financial problems. This must be balanced against the invaluable flexibility that the carriers have been able to exercise in adjusting their fares freely as changing market, supply and cost circumstances warranted. In my opinion, the proposed cure of re-regulation would be no solution. It would be far preferable to let competition continue while the emerging economic recovery takes over to restore demand and improve yields.

Some have asserted that deregulation has permitted inequities to arise in pricing on low-density and short-haul routes, compared to, for example, the high-density transcontinental markets. Such pricing, however, is simply a reflection of actual airline cost differentials. The CAB's recent evaluation of deregulation, *Competition and the Airlines*, shows that the real inequity in fares occurred prior to deregulation, when the CAB mandated fares in many short-haul markets that were actually below the cost of service, while also setting fares above costs in markets of more than 400 miles. Since deregulation, carriers have the freedom to institute pricing that better reflects the actual cost of operation on a specific route. The CAB's analysis shows that cost per available seat mile falls repidly with the distance of the route operated. In 1981, the average operating cost per revenue passenger mile, at 60 percent load factors, was more than three times as high for smaller aircraft (DC-9-30) on 200-mile routes, as for large aircraft (B-747) on 2500-mile routes.

The differential in airline operating costs increases further if the market is very thin. It is essential that carriers have the flexibility to tailor equipment and schedules to fit the short-haul, thin routes in order to keep costs and fares at a reasonable level. I believe it is a tribute to the industry that they have achieved efficien-

cies which have enabled them to hold the rate of increase in average airline fares below that of the Consumer Price Index, despite extraordinary cost pressures.

Service to cities of different sizes is also an important issue in airline deregulation. There have been two main changes in this area. Between May 1978 and May 1983, the number of departures has increased at large hubs by 15.7 percent, at medium hubs by 22.5 percent, and at small hubs by 12.4 percent, while departures dropped at nonhubs by 2.8 percent. The losses at nonhubs are accounted for by decreased flights from nonhubs to small hubs and other nonhubs, while service from nonhubs to large and medium hubs is up significantly. In general, these changes reflect carrier efforts to establish efficient networks by concentrating on hub-and-spoke operations. Now, although nonhubs have had a small decrease in total departures, their increased service to medium and large hubs provides them better overall access to air transportation through a multitude of connecting opportunities at large and medium hub airports.

The Essential Air Service (EAS) program ensures that all communities receiving certificated air service prior to 1978 will continue to be served through 1988. This contrasts with the period 1960–1976, when service to 173 communities was dropped by certificated airlines. Although EAS has permitted major carriers to withdraw from communities, they have been replaced by smaller carriers. These replacement carriers have usually been able to provide more frequent service through use of smaller aircraft more suited to the traffic and service needs. In fact, in the 74 communities where the majors and nationals dropped service since deregulation, total departures increased by 26 percent, due to increased operations by regional and commuter airlines.

Finally, I believe we should consider how airline deregulation has contributed to meeting the needs of the travelling public. Deregulation has given the travelling public a much broader range of choices, choices that it never had before. Today it is the public's needs and demands which are the driving force in industry decisions. The industry has responded extremely well to customer demand under very trying economic conditions, by re-aligning routes and schedules, by introducing "no-frills" service to supplement premium service, by adjusting fares to reflect cost differentials, and by introducing a wide variety of fare options.

In summary, I believe a compelling case for deregulations is being made in the marketplace. The best evidence I can present for continuing along this course is the fact that there is no cry in the commercial airline industry nor among its users for a return to extensive government regulation. Secretary Dole has asked me to convey to the Committee her own strong and personal commitment to airline deregulation. We believe there should be no turning back.

QUESTIONS OF SENATOR HOLLINGS AND THE ANSWERS THERETO

Question. You testified that the best evidence for continuing along the course of deregulation is the fact that there is no cry in the commercial airline industry for government regulation. On the second day of these oversight hearings, Republic Airlines came out in favor of limited fare regulation. Could this represent a trickle that, left unresolved, could grow into a flood of sentiment against deregulation?

Answer. No, I do not think we will see a large shift in support of re-regulation. I believe the vast majority of air carriers and consumers support deregulation, have from pricing flexibility, and would oppose a return to regulated fares.

If you evaluate the various proposals, including Republic's, that have been made to re-regulate fares, you will find a great many flaws. In general, these proposals would eliminate the carrier's freedom to price their services efficiently and competitively, while also harming consumers by curtailing low fares.

I also believe that, as the economy improves and airline travel increases, arguments for fare regulation will diminish significantly.

Question. In the first quarter of 1983, interest rates were down, as was inflation and fuel prices. Still the 11 major airlines lost $567 million in operating costs. Why have the airlines continued to lose such large sums of money, when you stated that the primary culprit, the economy, has begun to turn around?

Answer. In the first quarter of 1983, demand for air travel was still quite low, in part because the first quarter traditionally is the lowest point during the year and also because economic activity was still sluggish at that time. We expect to see the effect of increased economic activity on airlines business in the last nine months of 1983. In fact, the Air Transport Association's senior economist has predicted an operating profit of $850 million to $1.5 billion during the second, third, and fourth quarters of 1983.

Question. Many people are tossing about ideas on reviewing deregulation through the means of a Presidential Commission. What are your views on such a Commission?

Answer. I think that DOT, CAB, and the ATA have presented ample evidence that airlines, consumers, and communities have been better off under deregulation than if airline regulation had continued. I doubt that a Presidential Commission could add anything to the record that has been compiled in hearings before both the Senate and House Aviation Subcommittees this year.

Question. Much of the testimony at these hearings focused on the decline of service to smaller communities. What can you suggest to the Committee as possible avenues for ensuring that these smaller cities receive adequate service in the future? Would you favor revising the Essential Air Service program?

Answer. I believe that the Essential Air Service program has generally fulfilled the objectives of Congress—to provide a ten-year transition period during which communities that received certificated air service would continue to receive scheduled air service. We don't envision any significant revisions in the program.

QUESTION OF SENATOR RIEGLE AND THE ANSWER THERETO

Question. Due to the air traffic controllers strike, restrictions have been placed on the aviation industry through the center and major slot program. Center slot requirements are being phased out throughout this year. However, major airport slot and flow control requirements will continue. It is not healthy to restrict the growth of any industry and this is the end result of slot requirements. Until capacity is increased, maximum productivity of available airspace with equal access to all is a must. This raises several questions.

a. What immediate short term and long term alternatives can be pursued to provide unrestricted capacity at major hubs?

b. Until restrictions can be eliminated, how can available slots be fairly allocated?

1. Is first come, first served, the best policy?

2. Should slots be sold to carriers with the risk of major carriers gaining a monopoly?

3. Should slots be allocated by lottery?

4. Should slots be allocated by priority ranking such as EAS replacement carriers first, new carrier service second, expanding carrier service third, etc.?

5. Should slots that remain unused for a designated period of time be required to be returned to the pool or sold?

6. Can slots be sold to another carrier at any time?

Answer. a. Slots and other flow control measures are imposed by the Federal Aviation Administration (FAA) only to guarantee the safe and efficient operation of the Nation's airspace. Flow control, in one form or another, has proven necessary to handle airspace limitations for a variety of reasons. For example:

Where the limitation has been caused by a shortage of controllers, which has been a national problem for the last two years, we have hired and trained more controllers. We are also, of course, always working to improve their efficiency. As announced, slot restrictions under our Interim Operations Plan (with the exception of Chicago's O'Hare, Denver, and Los Angeles International) should disappear this year;

Where the limitation is the physical capacity of the airport, it can be enlarged or a new airport may be built, solutions which are often unacceptable to the locality served by the airport or its operator;

Where the limitation is caused by the concentrated scheduling of air carrier operations to serve "peak" morning and evening periods, the solution is more complicated. Carriers can voluntarily shift flights to earlier and later hours. Air traffic delays can be dealt with on a "first-come, first-served" basis or other procedure through the air traffic control system. Finally, slot limits such as those imposed under the High Density Rule at LaGuardia, O'Hare, Kennedy, and Washington National can be used. The FAA prefers not to use permanent, inflexible slot arrangements and has therefore proposed to eliminate the High Density Rule restrictions at all but National Airport.

b. We believe our present regulatory system (Special Federal Aviation Regulation No. 44-5) has been and remains the best method for dealing with the temporary shortage of airspace capacity. That system allocates newly available slots, which have become available as we have increased capacity over the last two years, and does not address distributing a number of slots that will remain fixed, as at National Airport.

1. "First come-first served" access to slots presented many equity problems and we abandoned it early in the Interim Operations Program.
2. We experimented with a sales policy in 1982, and found both benefits and disadvantages with it.
3. Our present selection system gave each carrier a position in line to select newly available slots on the basis of an initial lottery. A lottery of actual slots would be disruptive in our view.
4. Our present system of ranking has recognized some priorities among carriers. It has worked quite well.
5. Slots that are not used should be returned for redistribution as is the rule under the current system.
6. Slots may not be sold under the current system.

Senator KASSEBAUM. Thank you very much, Mr. Willis. I think that we will go down and hear the rest of the panelists and then ask some questions.

Mr. McKinnon.

STATEMENT OF HON. DAN McKINNON, CHAIRMAN, CIVIL AERONAUTICS BOARD

Mr. MCKINNON. Madam Chairman, it has been nearly 5 years since the passage of the Airline Deregulation Act, and the entire structure of this highly regulated airline industry has changed in that time. Established carriers have revamped their route networks to a hub-and-spoke concept.

New airlines have sprung into service, and pricing policies have been revolutionized. We have not created the perfect system, but the passengers, the airlines, and the aerospace industry are in better shape today under deregulation than they would have been under the old regulations.

There is still some fine tuning to be done in this new system, but we now have the right system which the CAB and our successor can fine tune. At the start of deregulation there was some hesitation by some airlines but today virtually all airline managements that I have talked with are happy with the idea of making decisions themselves on how to run their airlines without having us, the Government, telling them what they can and cannot do.

They want to win or lose on their own without Government regulation. They want their skills and talents and energies and employees to be the determining factor in their success.

There have been some adjustments. Routes are now tailored to meet traffic demands. Peak pricing is now used to balance demand, and equipment is used more efficiently and effectively in this highly capital intensive industry.

No longer does a 727 stop by some small town once a day and pick up a half a dozen passengers and head for the next little community to collect a few more travelers on the way to the big city. Those 140-seat aircraft are used more efficiently from major city to major city.

The commuter airline industry has exploded to fill the gap. Small commuter aircraft go to the smallest towns, load up several times a day and make nonstop or one-stop flights, usually of an hour or less to a major hub so that their passengers can connect into the domestic air transportation system.

Those communities have exchanged jets for the convenience of more frequent flights aboard smaller aircraft bound for the large hubs. In addition, this offers more efficient use of the aircraft.

The industry has grown tremendously in the last 5 years. In 1978 there were 34 trunk, regional and local carriers operating jet equipment. Today, there are 53 airlines in the same categories.

A number of new carriers who offer scheduled interstate service are former charter operators. Some are former intrastate carriers and more than 10 are totally new airlines.

Yes, as some have said there have been some bumps along the deregulation road that have caused some to reminisce about the good old days of Government control of the airlines. Clearly, some communities have lost service, and some carriers have had difficulty in adapting to a competitive environment.

Nevertheless, the vast majority of the American traveling public receives better service at lower prices than they would have under the old system. The more relaxed regulatory climate encourages air carriers to become more productive, reduce costs, and satisfy passengers.

Financial planning for airlines presented a huge challenge. Although they are currently stable, fuel prices doubled after the Airline Deregulation Act passed.

Fuel accounts for roughly one-third of an airline's expenses. So when fuel expenses doubled, the air carriers suffered huge losses and would have under regulation or deregulation. The difference is that under regulation there would have been little competitive pressure to improve efficiency. Carriers would have just come to the CAB for a rate increase, and the passengers would end up paying higher fares.

With fuel costs rising rapidly, there was a desire to purchase more fuel efficient equipment, but interest rates climbed to the highest point in recent history. The double digit interest rates made fleet modernization very expensive. Then the recession arrived, and airlines had many more seats than passengers.

As a result fare wars erupted, lowering yields and usually profits. Then the air traffic controllers strike restricted and froze many routes.

Suddenly carriers couldn't adjust service to match their fleet with the demand. In the last 3 years the U.S. airlines have lost $1 billion dollars. That caused some people to conclude that deregulation was not working.

Yet we can learn from a comparison on this point. The IATA carriers last year alone lost $2.1 billion and that was in a highly regulated environment. So the regulation/deregulation distinction fails to explain the losses.

There are much greater economic forces at work affecting profits than regulation or deregulation in today's world economic climate. Last year alone 50,000 businesses in the United States entered chapter 11 or chapter 7 bankruptcy so to expect the airline business to be fat with profits when the rest of the businesses in this country are suffering really doesn't make much sense.

Especially in these tough economic times, the Airline Deregulation Act has forced management to assume their proper role,

manage efficiently or face extinction just like any other business. Here again rapid growth of the new entrants is important.

First, these new carriers have shown a willingness to experiment with different types of service and to serve underutilized airports in major metropolitan areas. Second, they have been an important stimulant to price competition.

But perhaps most significantly, these carriers have managed to provide air service at much lower cost than their competitors, and their growth has encouraged their competitors to become more efficient. Labor productivity improved and costs have moderated.

So the passenger, the flying consumer, has benefited. Passengers who have to connect generally prefer to travel on a single airline. By not changing carriers, passengers reduce their chances of missing a connection or losing baggage. They also frequently avoid a long walk at the terminal.

In 1978 over 30 percent of the domestic passengers had to change planes to reach their ultimate destinations. Forty-one percent of those connecting passengers had to change airlines.

By 1982 the percentage of passengers that had to change planes remained about the same, but less than 20 percent had to change airlines. This is a passenger benefit of the new hub-and-spoke route patterns.

The real answers in the economics of the airline business, however, affect the small markets. The small markets are more costly to serve passengers on a per-mile basis than are the longer hauls in big markets.

Small markets are generally shorter hauls to a regional hub. They are served with smaller aircraft and are generally operated at lower load factors.

The expense of maintaining ground facilities and staff at each point is spread among fewer passengers. On long hauls where discretionary traffic is especially important, the recession has reduced demand.

Long haul markets are generally served by three and four engine wide bodied equipment which cannot be profitably used anywhere else. As demand declined, carriers were faced with the alternatives of grounding their expensive wide bodied equipment or cutting prices to fill up empty seats.

They have found it more profitable and cost effective to cut fares, and if a carrier tries to price above a modest profit passengers can use alternative routings or competitors can undercut the price. The bottom line is that fare differences among markets are largely explained by costs differences.

So what will the future hold? The next 4 years should be far more prosperous. The economy is expanding and there are already signs that the demand for air travel is increasing.

In addition, airline cost increases have moderated. Despite these improvements, some carriers will inevitably encounter difficulties just as some communities will be less than satisfied with the amount of air service they are receiving. Yet, the evidence convincingly shows, that for consumers as a whole, service quality is better and fares are lower in today's competitive environment.

Although the free market is functioning less than perfectly, it has been far more successful than the Government had been in de-

termining which carrier should serve which routes and what prices they should charge. The airlines have staked their financial future on a belief that the Congress meant what it said about restructuring the industry forever with a deregulated competitive environment. To try to go back could cause the bankruptcy of many airlines.

This has been a brief overview, Madam Chairman, and I have some other comments that I would like to insert in the record and after you finish with the rest of the panel, answer your questions.

[The statement follows:]

STATEMENT OF HON. DAN MCKINNON, CHAIRMAN, CIVIL AERONAUTICS BOARD

Its been nearly five years since the passage of the Airline Deregulation Act and the entire structure of the highly regulated airline industry has changed in that time.

Established carriers have revamped their route networks to a hub-and-spoke concept.

New airlines have sprung into service.

And pricing policies have been revolutionized.

We have not created "the perfect system".

But the passengers, the airlines and the aerospace industry are in better shape today under dereguation than they would have been under the old regulations.

There is still fine turning to be done to this new system, but now we have the right system which the CAB and our successor can fine tune.

At the start of deregulation, there was some hesitation by some airlines, but today, virtually all airline managements I've talked with, are happy with the idea of making decisions themseleves on how to run their airlines—without having us—the government—telling them what they can and cannot do.

They want to win or lose on their own—without government regulation. They want their skills, talents, energies, and employees to be the determining factor in their success.

There have been some adjustments:

Routes are now tailored to meet traffic demands;

Peak pricing is now used to balance demand; and

Equipment is used more efficiently and effectively in this capital intensive industry.

No longer does a 727 stop by some small town once a day and pick up a half a dozen passengers and head for the next little community to collect a few more travelers on the way to the big city.

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Yes, there have been some bumps along the deregulation road that have caused some to reminisce about the "good old days" of government control of the airlines.

Clearly, some communities have lost service, and some carriers have had difficulty in adapting to a competitive regime.

Nevertheless, the vast majority of the American traveling public receives better service at lower prices than they would have under the old system. The more relaxed regulatory climate encourages air carriers to become more productive, reduce costs, and satisfy passengers.

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Altough they are currently stable, fuel prices doubled after the Deregulation Act passed.

Fuel accounts for roughly one-third of an airline's expenses. So when fuel expenses doubled, the air carriers suffered huge losses—and would have under regulation or deregulation.

The difference is that under regulation there would have been little competitive pressure to improve efficiency, carriers would have just come to the CAB for a rate increase and the passengers would end up paying much higher fares.

With fuel costs rising rapidly, there was a desire to purchase more fuel efficient equipment—but interest rates climbed to the highest point in recent history.

The double digit interest rates made fleet modernization very expensive.

Then the recession arrived and airlines had many more seats than passengers.

As a result, fare wars erupted, lowering yields and usually profits.

Then the Air Traffic Controllers strike restricted and froze many routes.

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Especially in these tough economic times, the Airline Deregulation Act has forced management to assume their proper role—manage efficently or face extinction—just like any other business.

Here again, rapid growth of the new entrants is important.

First, these new carriers have shown a willingness to experiment with different types of service and to serve underutilized airports in major metropolitan areas.

Second, they have been an important stimulant to price competition.

But perhaps most significantly, these carriers have managed to provide air service at much lower costs than their competitors.

And their growth has encouraged their competitors to become more efficient.

Labor productivity improved and costs have moderated.

For example, since 1978, the number of available-ton-miles produced per employee at major airlines has increased by over eight percent.

The increased competitiveness of this industry is also demonstrated by what has happened to prices and costs.

Since the Board began relaxing its regulation of fares, the carriers have taken steps to improve productivity.

So while costs the airlines pay for fuel, labor and supplies have doubled, overall airline cost per available-ton-mile to provide air service increased by 80 percent.

Between 1976 and 1982, passengers fares increased by 51 percent—less than the increase in the consumer price index.

Let me summarize those statistics because they are important.

The prices the carriers had to pay for goods and services went up 100 percent.

Through their new-found efficiencies they were able to increase fares by only 51 percent.

So the passenger—the flying consumer—has benefited.

Passengers who have to "connect" generally prefer to travel on a single airline.

By not changing carriers, passengers reduce their chances of missing a connection or losing baggage.

They also frequently avoid a long walk at the terminal.

In 1978, over 30 percent of the domestic passengers had to change planes to reach their ultimate destinations.

Forty-one percent of these connecting passengers had to change airlines.

By 1982, the percentage of passengers that had to change planes remained about the same, but less than 20 percent had to change airlines.

This is a passenger benefit of the new hub-and-spoke route patterns.

Now on the topic of fares, in addition to the moderation of fares, deregulation inspired important changes in the fare structure.

The most significant development in this regard, is the increased use of peak-load pricing.

With peak-load pricing, aircraft are used more efficiently and carriers give better service to time-sensitive passengers.

The most frequent complaint about deregulation is that a passenger in one market may pay less than someone traveling one-half the distance in another market.

Some claim that these price differences are price discrimination, or that travelers from small cities are subsidizing travelers from large cities.

However, the real answers are in the economics of the airline business.

Smaller markets are more costly to serve per passenger mile than are longer hauls in bigger markets.

Small markets are generally shorter hauls to a regional hub.

They are served with smaller aircraft and are generally operated at lower load factors.

The expense of maintaining ground facilities and staff at each point is spread among fewer passengers.

On long hauls, where discretionary traffic is especially important, the recession reduced demand.

Long haul markets are generally served by three- and four-engine widebodied equipment which cannot be profitably used elsewhere.

As demand declined, carriers were faced with the alternatives of grounding their widebodied equipment or cutting prices to fill up empty seats.

They have found it more profitable and cost effective to cut fares. And, if a carrier tries to price above a modest profit, passengers can use alternatives routings or competitors can undercut the price.

The bottom line is that fare differences among markets are largely explained by cost differences.

So what will the future hold?

The next four years should be far more prosperous. The economy is expanding and there are already signs that the demand for air travel is increasing. In addition, airline cost increases have moderated.

Despite these improvements, some carriers will inevitably encounter difficulties, just as some communities will be less than satisfied with the amount of air service they are receiving.

Yet, the evidence convincingly shows, that for consumers as a whole, service quality is better and fares are lower in today's competitive environment.

Although the free market is functioning less than perfectly, it has been far more successful than the government had been in determining which carriers should serve which routes and what prices they should charge.

The airlines have staked their financial future on a belief that the Congress meant what it said about restructuring the industry forever in a deregulated competitive environment.

To try and go back could cause the bankruptcy of many airlines.

This has been a brief overview, Mr. Chairman, but there are other more detailed thoughts on deregulation that should be part of the record.

I would ask they be included so that I can now address any questions you may have.

Supplemental Statement

When Congress passed the Airline Deregulation Act it recognized that there would be changes. Indeed, it was the perception that change was desirable that spurred passage of the Act.

Ending 40 years of strict government control over airlines' basic operating decisions has had a substantial effect. In the last five years, we have seen formerly regulated carriers revamping their route networks, new airlines beginning service, and an apparent revolution in pricing policies.

In this testimony, I first review the effect of deregulation on airline route realignments, new entry and pricing and then offer an assessment of the current state of the industry.

At the outset, let me stress that airline deregulation is providing a better air transportation system.

Clearly, some communities have lost service, and some carriers have had difficulty in adapting to a competitive regime. Nevertheless, the vast majority of the American traveling public is receiving better service at lower prices than they would have under strict regulation. Moreover, the more relaxed regulatory climate is aiding air carriers in becoming more productive, thereby reducing costs.

Route realignments

In January 1979, only a few months after the Airline Deregulation Act was passed, the Board adopted procedures which gave carriers fairly wide discretion to determine their markets.

Carriers responded to this increased freedom by aggressively adding and deleting routes from their systems.

Among other things, this realignment in carrier route systems has produced a major restructuring of the industry. The share of the trunks, the largest airlines, has fallen from 88 percent of total revenue-passenger-miles in 1978 to 79 percent in 1982.

Meanwhile, the former local service carriers' traffic has increased by 63 percent during the same year: last year, carriers like USAir, Piedmont and Frontier, accounted for over 13 percent of domestic traffic.

Carriers' decisons on what routes to serve are based on a variety of factors including aircraft availability, fares, and expected traffic growth.

Maybe the most important factor in determining the success of entry is connecting flights for the entered route. Indeed, the former local service carriers' hub-and-spoke system may explain their relative success.

In domestic air service, there are over 50,000 city pairs between which passengers travel. Yet there is sufficient traffic to support nonstop service on less than 5 percent of them.

For example, passengers traveling from small cities in the south to Chicago or Washington often stop over or connect in Atlanta, thereby using it as a hub. Indeed, about 60 percent of the passengers flying on routes from small communities to large hubs are ultimately headed to some place else.

Passengers that make intermediate stops generally prefer to travel on a single airline. By not changing airlines, a passenger reduces the chances of missing a connection or losing baggage; frequently, the passenger also avoids a long walk between terminals.

Under regulation, local carriers often provided service from small communities to a regional hub, where passengers continued on another airline. With the ability to enter new routes, these former local service carriers began to serve cities that were the ultimate destinations of their passengers.

The rapid growth of these carriers under deregulation has encouraged all the formerly regulated carriers to develop hub-and-spoke systems.

As a consequence, the passengers that need to make intermediate stops have more convenient service available.

In 1978, prior to the passage of the Airline Deregulation Act, over 30 percent of the domestic passengers had to change planes. We found that in markets with more than ten passengers per day, 41 percent of these connecting passengers had to change airlines. By 1982, the percentage of passengers that had to make connections remained about the same, but less than 20 percent of them had to change airlines.

Passengers from small communities have benefited from the growth of hub-and-spoke operations. Although their total departures are down since 1978, small communities are receiving more service to large hubs where convenient connections are available. Fewer of their flights are "milk-runs".

But the service is less likely to be by jet. Passengers prefer jet service; however, it doesn't pay for large aircraft to serve a small community for only a handful of passengers.

Small community residents as well as other taxpayers benefit from a system that promotes more convenient service at reduced cost to smaller cities.

The new entrants

At the same time that the formerly regulated carriers have been concentrating on hub-and-spoke systems, a number of new carriers are now providing scheduled interstate service. Some of these are former charter operators, some are former intrastate carriers and more than ten are totally new airlines.

Initially, new entrant airlines provided low-priced, low-frill service. They generally served heavily traveled markets and concentrated on serving the point-to-point traveler. For example, Capitol and World instituted service between New York and Los Angeles, and New York Air entered New York-Washington market. Since the new carriers' costs are generally much lower than the formerly regulated carriers, they can be profitable at fares substantially below prevailing levels.

At first, the established carriers allowed new entrants to maintain a price advantage, but passengers demonstrated that they were price sensitive. As the new entrants' traffic surged, the incumbents' load factors fell and they were forced to meet the lower fares.

Without a price advantage, the growth rates of several of the new entrants slowed considerably; travelers preferred airlines with established reputations, especially when they offered a higher level of service.

Although some new carriers have had difficulties, others continue to expand and new airlines are being formed.

Increasingly new entrants are changing their marketing strategies. For example, the new entrants often serve secondary airports, like Newark and Midway, in major cities.

They are now more apt to stress connecting service in their route planning.

One new entrant offers no frills: no complimentary food service, not even free checking of baggage.

At the other extreme, one new airline is offering first-class service at coach prices.

In 1978, prior to the passage of the Act, the four intrastate carriers carried about 2.5 percent of the scheduled jet passenger miles. By 1982, these carriers combined with the former charter operators and the new firms accounted for nearly eight percent of the industry's domestic revenue passenger miles.

If anything, their market share understates their importance. First, they have shown a willingness to experiment with different types of amenities and to serve underutilized airports in major metropolitan areas. Second, they have stimulated price competition; their markets have significantly lower fares than otherwise similar markets.

But perhaps most importantly, these carriers have much lower costs than their larger competitors.

Years of government regulation not only prevented carriers from developing efficient route systems, it limited the incentives to keep costs low by passing through cost increases to the consumer.

Since the introduction of jet equipment in the early 1960s, the wages of airline employees have grown more rapidly than those in other sectors of the economy.

In addition, work rules became more restrictive. For example, the actual flight time of pilots with the largest airlines declined from 60 hours per month in the 1960s to less than 50 hours per hour in 1982.

The new scheduled carriers, and most notably the newly-formed companies, have significantly lower costs. They tend to pay lower salaries, and they tend to be more productive. For example, their pilots typically fly 50 percent more hours per month than the formerly regulated carriers, and job classifications of the new carriers tend to be more flexible.

Competition from these lower cost airlines has forced the formerly regulated carriers to reduce their costs. The employees at a number of airlines have agreed to wage reductions and to relax their work rules. As a result, labor productivity is improving and cost increases are moderating.

For example, since 1978, the number of available-ton-miles produced per employee at major airlines has increased by over eight percent. Nevertheless, the cost difference between the incumbent carriers and the new entrants remain substantial.

The continued growth of both the new entrants and the relatively efficient incumbents will provide continued incentives for carriers to reduce their costs.

Pricing trends

As I have indicated, the realignment of the former regulated carrier route networks coupled with the entry of new airlines has led to a fundamental shift in the competitive structure of the industry.

Not only has the number of airlines providing nonstop service in a given market increased, but the growth of hub-and-spoke operations has led to increased availability of competitive connecting services. A passenger traveling between Washington and Phoenix can choose among a variety of carriers offering a number of different intermediate stops.

The increased competition in the industry is clearly demonstrated by what has happened to prices. Since 1976, the year before the Board began to relax its regulation of fares, the prices that airlines pay for fuel, labor, and supplies more than doubled.

In the face of these dramatic price increases, the carriers were taking steps to improve productivity so their costs increased by only 80 percent.

Yet between 1976 and 1982 passenger fares increased by only 51 percent, less than the increase in the consumer price index.

Part of this moderation in fare increases stems from the well-publicized, extraordinarily low fares in long-haul transcontinental markets. But New York to Los Angeles is not the only market in which travel bargains have been available. Low fares

have been offered by new entrants and established carriers alike in markets such as Tulsa to Dallas and Burlington to New York.

Deregulation also changed the structure of fares. Perhaps the most significant development in this regard is the increased use of peak-load pricing.

Air travel varies by the hour, the day and the season. Friday afternoons is the most popular time to travel.

When the industry was regulated, the Board limited carriers' ability to vary fares by the time of travel. Thus, someone traveling on Friday afternoon paid the same fare as another person traveling on a Sunday morning.

Yet the cost of serving a peak passenger is much higher. Air carrier investments in equipment as well as employment levels are largely determined by the demand for peak-period travel.

In addition, if the price for peak-period travel is higher, some passengers will elect to take less convenient flights. With peak-period demand reduced, carriers need less equipment, and so their costs are reduced. In addition, peak-load pricing improves the ability of time-sensitive passengers to get seats on their preferred flights.

Although some airlines use an explicit peak/off-peak fares, most achieve essentially the same result by offering capacity controlled discount fares. Because a smaller proportion of seats are available at a discount during popular travel times, the average fare paid by passengers on these flights is higher.

The success of these pricing policies is demonstrated by the high percentage of seats the airlines are filling. Despite the difficult environment, load factors last year were higher than they had been in the fifteen years that preceded deregulation.

When the Board began relaxing its fare regulations, the restricted discount fares produced a number of complaints. For example, some passengers believed it unfair that the passenger in an adjacent seat paid a substantially lower fare.

Apparently, there has been an increased recognition that different types of travelers make different demands on airlines, and consequently a price differential is justified.

Now, the most frequent complaint concerns the differences in fares among markets. It is not uncommon for a passenger in one market to pay less than someone traveling in another market that is one-half the distance. These price disparities have elicited claims that carriers are engaging in price discrimination, or that travelers from small cities are subsidizing those from large cities.

But by and large, fare differences among markets seem to be cost related. On a passenger-mile basis, the cost of serving many of these smaller markets is substantially higher than the cost of serving dense long-haul markets.

In the first place, jet aircraft are much more efficient in serving long-haul markets where a large fraction of travel time is spent cruising at high altitudes.

In addition, since ground transportation is a viable option for many travelers in short-haul markets, carriers must offer well-timed flights in relatively small aircraft. For this reason, aircraft on thinly traveled short-haul markets tend to operate at relatively low load factors, which further increases costs.

Finally, as I have already said, a large proportion of passengers in small markets make connections to reach their ultimate destinations. This requires airlines to have flights from a number of destinations arrive and depart within a short period of time. This increases operating expenses since airlines cannot evenly spread the use of their airport facilities and employees throughout the day. It takes more resources to handle 20 arrivals and departures within an hour than it takes to handle the same number of operations over ten hours.

But factors like aircraft size, load factors, and distance do not fully explain the fare differences that have been observed between long- and short-haul markets. The recent economic slump has substantially reduced demand for air service in many long-haul markets where discretionary traffic is especially important.

These markets are predominantly served by three- and four-engine wide-bodied equipment which cannot be profitably used elsewhere. As demand declined, carriers were faced with the alternatives of grounding their wide-bodied equipment or cutting prices to fill up empty seats.

Most carriers have found it more profitable to cut prices, and consequently fares in many of these markets have been well below fully allocated costs. Thus, fares in these dense, long-haul markets do not cover the cost of the aircraft and overhead; they do, however cover out-of-pocket costs for fuel, crew, and landing fees.

Our analyses indicate that fare differences among markets are largely explained by cost differences. Clearly market structure plays some role. However, the ease of entry and the availability of alternative routings limit carriers' ability to price above a competitive level. Moreover, fare flexibility has enabled carriers to make more efficient use of their assets.

Implications of deregulation for the future

In the areas of route networks, new carrier entry, and pricing policies, deregulation has brought substantial positive changes to the airline industry. The industry is becoming more efficient, service convenience is improving and fares are being established by market conditions.

Despite important progress in each of these areas, other statistics give a different picture of the state of the industry.

Between 1978 and 1982 jet carriers' traffic grew by only fifteen percent averaging less than four percent per year; industry employment declined by about six percent to 303,000 people; and over the last three years the industry's operating losses were over a billion dollars. Carriers lost about 1.5 cents for every dollar of revenue they collected.

Needless to say, we are concerned by the poor profits and declining employment.

However, it is difficult to determine deregulation's contribution to these difficulties. Airline travel has traditionally been quite sensitive to both fare levels and the general level of economic activity. Although the price of air travel has not grown as rapidly as airline costs, air fares have increased significantly.

Since 1979, the economy has been quite sluggish. Both of those factors have depressed the growth in demand for air travel. Since the industry is becoming more efficient, airline employment has declined despite the moderate traffic growth. In addition, the strike and subsequent firing of 70 percent of the nation's air traffic controllers in the summer of 1981 caused costly disruptions to carrier operations.

If regulation had continued, air fares would have been higher. However, higher fares do not necessarily lead to higher revenues. Although each passenger would be paying more, fewer passengers would be traveling.

Moreover, if reduced traffic only produced fewer passengers per flight, then the reductions in traffic would not produce a significant reduction in costs; the cost of carrying an additional passenger in an otherwise empty seat is quite small.

It is noteworthy that airlines throughout the world, most of whom compete in tightly regulated environment and charge higher fares than domestic carriers, have recorded substanital losses in the past several years. Regardless of the regulatory regime, the last few years would have been difficult ones for the industry.

But deregulation has not only produced lower prices, it has also given carriers the unprecedented ability to determine the routes they serve.

Carriers have been able to exit unprofitable routes with less demand for their services and then enter ones with greater demand and better suited to their equipment and route networks.

This flexibility has been vital to many carriers.

In public statements as well as private conversations, a number of airline executives have noted that only in a deregulated environment could they have responded agressively and effectively to the string of adverse events buffeting the industry.

The deregulation of the airlines is producing what its advocates promised: a more efficient and responsive industry.

The developments I have discussed today indicate that the industry has made important strides—though not easy ones—in responding to the introduction of meaningful competiton for the first time in its history.

The transition is not yet complete. Airline management and employees alike will have to continue to work vigorously to keep costs under control.

The airline industry is quite competitive.

Efficient carriers will continue to expand; so high cost carriers will need to improve their operations or to shrink.

However, the next four years should be far more prosperous than the previous four. The economy is expanding and there are already signs that the demand for air travel is increasing. In addition, airline cost increases have slowed considerably and fuel prices, the prime culprit of the price spiral in 1979 and 1980, have declined somewhat.

Improved demand should lead to an increase in some prices and thus narrow the differences in fares between heavily and lightly traveled markets. Nevertheless, despite the recent adoption of a distance-based fare formula by a number of carriers, travelers in dense markets will continue to pay substantially lower fares. As I have already noted, on a passenger mile basis, the cost of serving dense markets is lower and this will ultimately be reflected in fare difference.

The continued fare differential will inevitably lead to periodic cries of cross-subsidy and price discrimination followed by a call for some form of deregulation. We would caution against any intervention. To begin with, the carriers that are serving markets where prices are relatively high are frequently not the same airlines that are serving the markets that consistently have very low fares.

More to the point, if we were to introduce price floors, carriers would have no reason to lower their prices in markets where fares are perceived to be too high. The profit-maximizing price between Fargo, North Dakota, and Minneapolis, Minnesota, is not materially affected by the fare between New York and Los Angeles.

On the other hand, if we were to establish fare ceilings, it is inevitable that prices in some markets would be set too low, and carriers serving these markets would be forced to reduce or even stop this service.

The last several years have clearly demonstrated that the marketplace can assure an efficient use of the airline industry's resources. It has produced better service as well as the expanded use of peak-load pricing and other innovative fare policies. Furthermore, competition is playing a vital role in encouraging carriers to become more efficient.

As the economy recovers, the industry's financial condition will certainly improve. Nevertheless, some carriers will inevitably encounter difficulties, just as some communities will be less than satisfied with the amount of air service they are receiving.

Yet, as I have discussed today, the evidence convincingly shows that for consumers as a whole, service quality is better and fares are lower in a competitive environment. Although the freemarket is functioning less than perfectly, it has been far more successful than the government had been in determining which carriers should serve which routes and what prices they should charge.

Questions of Senator Hollings and the Answers Thereto

Question. In his testimony, Mr. Willis from the Department of Transportation discussed a preference for continuing under deregulation, letting competition in the airline industry continue until the economic recovery takes over, leading to improved yields. In light of continuing financial setbacks in the airline industry, how long do you think the recovery will take before the financial condition of the industry improves? In other words, how long can we wait?

Answer. While it is true that airline earnings for the first five months of 1983 showed little change from the poor financial results of a year earlier, there are signs that the airlines financial performance may be turning around. The major factor in the poor airline performance in the later part of 1982 and early part of 1983 was the sluggish growth in demand and the resulting deterioration in RPM yield (average revenue per revenue passenger mile). There are signs that yield erosion has stopped for the leading airline group.

Month	Passenger revenue per RPM (yield) percent change over a year earlier	
	Majors	Short haul nationals
January 1983	(7.0)	(11.4)
February 1983	(9.6)	(10.4)
March 1983	(8.7)	(6.3)
April 1983	(3.3)	(3.5)
May 1983	1.5	(1)

[1] Not yet available.

In May 1983, the yield for the majors inceased for the first time after a long series of deteriorations. Also May 1983 operating results improved. With strong traffic reported for June and probable continuation of the yield improvement, second quarter operating results for the majors could show some slight improvement. The Air Transport Association has predicted an industry operating profit of between $200 and $800 million for 1983. This was developed after discussions with airline financial people. We have not made an independent forecast of 1983 earnings, but we do not believe the ATA estimate is unrealistic if favorable economic conditions continue to provide support for strong and positive traffic growth and if yield improvement continues. The ATA forecast implies that second quarter 1983 financial results

would show some improvement and that third quarter 1983 should provide strong improvement over year ago results.

Question. In the first quarter of 1983, interest rates were down, as were inflation and fuel prices. Still the 11 major airlines lost $567 million in operating costs. Why have the airlines continued to lose such large sums of money, when you stated that the primary culprit, the economy, has begun to turn around?

Answer. During the last three years of poor airline financial performance, different factors have come into play at various times during the period. Certainly the weak economy has been *the* major factor when the entire three year period is taken into consideration. Certainly the economy has also been *a* factor in recent months. However as stated in answer to Question 1, prices seem to be firming in response to strengthening demand and traffic is continuing to expand. It should be emphasized that the first quarter is traditionally the least profitable for the industry and substantial losses are common even in very profitable years.

Question. You stated in your testimony that if we had continued under regulation, air fares would have been higher. Please provide for the record a comparison of how fares under deregulation would compare to regulated fares today.

Answer. Estimation of the level of regulated fares today would be speculative. Nevertheless, a few suggestive calculations can be made. From the fourth quarter of 1978 to the fourth quarter of 1982, average yield per revenue ton mile increased by 42.3 percent for trunk and local carriers, combined. Over the same period, cost per RTM increased by 57.2 percent. Thus, if the effect of higher fares on traffic were ignored, an increase of 10.5 percent over today's fares would be required to maintain the same relationship between yield and cost as in the earlier period. Including the effect of price level on demand would require an even greater fare increase.

Additionally, since deregulation, the cross subsidization of short haul operations (generally higher unit costs) by long haul operations (generally lower unit costs) has declined. The emphasis has now been placed on specific market characteristics such as density in attempting to match fares with these specific costs. Thus a more rational relationship between yield and cost by stage length has developed since deregulation.

Question. Many people are tossing about ideas on reviewing deregulation through the means of a Presidential Commission. What are your views on such a Commission.

Answer. I believe that now is the time to move forward with the phased deregulation and sunset plan set by Congress in 1978. Deregulation of air transportation has been under continuous review and study by the industry, Congressional committees, and by the Board, since that time. Adjustments that have been needed were recognized, and where necessary, the Board took steps to help in those adjustments. Further study now seems superfluous. But if Congress believes that a Presidential Commission is needed at this point, I recommend that it be separately funded outside of the Boards budget. Our staff and resources are now stretched to the breaking point.

Question. Much of the testimony at these hearings focused on the decline of service to smaller communities. What can you suggest to the Committee as possible avenues for ensuring that these smaller cities receive adequate service in the future? Would you favor revising the Essential Air Service program?

Answer. Admittedly, there has been a decline in the level of service at small communities since 1978. A comparison of service data for June 1978 to June 1982 shows that the total number of weekly departures at non-hub (small) communities in the 48 states declined by approximately 10 percent of 29,635 to 26,725 and the total number of available outbound seats per week at the non-hub communities declined by approximately 20 percent from 1,214,187 to 970,415. Traffic has declined as well. Reports filed by air carriers show that traffic at the essential air service points located within the 48 states decreased from 12,079,382 enplanements for 1976 to 10,947,669 in 1982, and overall reduction of 9.4 percent.

We suspect that a large part of the decline in the number of seats provided at small communities over this period is a result of the replacement of certificated service operated with larger aircraft—40-seat or larger aircraft—by commuter carrier operations with 15–19 seat aircraft. However, many of these points were receiving substantially more seats than required to accommodate their limited traffic demand because the certificated carriers serving them had up-graded their fleets by eliminating their smaller aircraft and replacing them with larger jets. There were many excess seats available, flying empty, at great cost to the taxpayer. Consequently, the substitution of service with smaller aircraft at these small communities has been a rational and necessary adjustment to the air transportation system.

More importantly, the service and traffic data available to us show that the levels of service provided to the small communities covered by the essential air service

program over the past few years have been adequate to accommodate all of these points' traffic demand at reasonable load factors. As support for this conclusion, we note that the initial essential air service capacity requirements established in 1979–1980 were based on the number of passengers enplaned at the communities during 1978, a high point of the economic cycle, and assumed a load factor standard ranging from 50 to 65 percent. Since 1978 was a peak year in terms of traffic levels at almost all communities, the determinations based on 1978 traffic have required a higher level of capacity that has been over the past few years when traffic has been falling during the downturn of the economic cycle.

Furthermore, based on our experience in individual essential air service cases that we have processed over the past few years, almost without exception the carriers serving small communities are operating at load factors under 50 percent.

As a result, we believe that the service declines at the small communities have been caused substantially by the reduced demand for air service at these communities and have occurred as a response to the fall-off in traffic. There are several probable causes for the traffic declines. First, the general decrease in economic activity has bad a pronounced effect on traffic levels. Second, many small communities located near alternative air transportation centers with higher levels of service and fare options have experienced traffic declines due to the service/fare competition at the nearby alternative airport.

Based on these circumstances, we find that small communities are receiving sufficient service to meet their demand. Futhermore, should traffic demand increase and additional service be required, the Essential Air Service program as currently structured has the capability of adjusting to these changes and ensuring the provision of adequate service to meet the increased demand. If a community believes that its traffic is not being accommodated by the service being provided under its current essential air service determination, it may petition the Board at any time to review the circumstances and modify the definition. To date, no community has filed a petition for modification alleging that their current traffic levels are not being accommodated at reasonable load factors. Therefore, we do not recommend any revisions to the Essential Air Service program for this purpose.

Question. What has been the net loss of employment to the airline industry since deregulation?

Answer. Based upon the most currently available data, airline industry full time employment has decreased 4.95 percent between the beginning of deregulation (October 1978) and February 1983.

FULL TIME EMPLOYEES AS AT OCTOBER 31, 1978 AND FEBRUARY 28, 1983

	October 31, 1978	February 28, 1983	Percent change
Majors	291,612	263,670	(9.58)
Nationals	36,469	40,078	9.90
Regionals [1]	1,990	9,988	501.91
Industry	330,071	313,736	(4.95)

[1] Reflects current group composition. This includes all currently reporting new entrants (carriers certificated after "The Airline Deregulation Act of 1978") and excludes carriers who operated in both periods but failed to report accordingly.
() Parenthesis denotes decrease.

Question. You stated in your testimony that you believe that there is still some "fine tuning" to be done under deregulation. What specifically do you see happening in the coming months.

Answer. As I outlined in my testimony and in more detail in my statement for the record, on the economic side, as the economy improves, demand for air travel will increase. Carriers will have less need for deep discount fares to attract traffic. Yields should thus increase for those carriers able to hold their costs down, increasing their productivity. Also, commuter service will increase in operations and quality as new aircraft especially designed for this service come on-line. I see these trends less as "fine tuning," however, but as the continual adjustment to market conditions that deregulation demands.

The "fine tuning" must take place in legislation for implementation of the Airline Deregulation Act. That legislation *is* needed. There are entire functions of the Board that are not addressed in the Deregulation Act. Consumer protection is one; data collection is another; and the structure of any gaining agency is the third. Without some guidance from Congress over the coming months, the Board will have

to make post-sunset commitments on the basis of its interpretations of very vague statutory language (or the absence of language) and some programs may be ended that Congress would have wished to continue. The Board is now reviewing its position on these issues for possible recommendations to Congress.

QUESTIONS OF SENATOR RIEGLE AND THE ANSWERS THERETO

Question. While it is difficult to determine poor airline performance after deregulation in 1978 due to the concurrent complicating factors of the national economic recession and air traffic controllers strike, the recession and the strike impact is easing, record revenue passengers are being carried, but poor airline financial reports and wide fare disparities exist. What can be done to resolve the remaining negative aspects of deregulation?

Answer. Since it was deregulated in 1978, the airline industry has experienced substantial losses and the structure of fares has changed significantly. Nevertheless, both of these developments are consistent with the operation of an efficient and competitive industry.

The airline industry has been buffeted by rapid increases in fuel prices, a prolonged recession, and a strike by the air traffic controllers. As a consequence of these events, the last few years would have been financially difficult ones for the carriers regardless of the regulatory climate. Recently, oil prices have eased, the economy has begun to expand, and the air traffic control restrictions are being relaxed. Consequently, carrier profits will improve as traffic and yield grow, while costs remain relatively stable.

Although the effect of deregulation on carrier profits is not entirely clear, the end of fare regulation has certainly altered the relationship of fares among markets. Previously, the fares in a market were established on the basis of distance. Now, prices are determined by the marketplace and cost is an important factor in determining the price of air transportation. In addition to distance, a number of factors determine the cost including the carrier's cost structure, the density of the market, and the quality of service. Consequently, it is not surprising to see markets of the same distance having different fares.

Also, the recession produced a temporary glut of certain widebodied equipment that can only be efficiently employed in a limited number of dense, long-haul markets. The excess supply of this equipment exerted downward pressure on prices in these markets. Recently, fares in long haul markets have firmed with the economic recovery. When the CAB regulated the industry, it deliberately established fares that were above costs in longhaul markets, and below costs in short-haul markets. Since fares under deregulation tend to be cost-based, the relationship between prices in long haul and short haul markets will be different from what it was when the industry was regulated.

Question. Major airlines with large aircraft have abandoned small communities for potentially larger major hub to major hub markets. While the replacement aircraft have to be sized to the market to reduce or eliminate subsidies, opposite extremes have often been the result. What can be done to provide minimum capability aircraft by replacement carriers which would include pressurization, toilet facilities (especially on longer flight segments), better handicapped person accessibility and consideration for cargo needs, even though the aircraft may be smaller?

Answer. At the time that the Board established its guidelines for determining essential air service requirements for individual communities (Part 398 of the Board's Regulations) it gave careful consideration to the aircraft requirements that should be included. A number of respondents to the proposed guidelines presented arguments that the Board should universally require pressurized aircraft for essential air service flights and that a minimum size of aircraft in terms of seat capacity should be imposed to ensure an acceptable quality of air service. There were also comments supporting the requirement that aircraft with cargo capability be utilized.

After carefully considering the statutory requirements of section 419 and weighing the advantages of imposing aircraft requirements and the costs that would be incurred both in terms of subsidy and in terms of limiting service options, the Board concluded that the only aircraft requirements that should be imposed as a general rule are that the aircraft should have at least two engines and have convenient cabin access through airstair door or similar type access. The Board concluded that above these basic requirements the carriers should be allowed to and would respond to marketplace needs. The Board has, however, considered the need for pressurized aircraft on a case-by-case basis in considering individual community's specific logis-

tical circumstances and essential air service needs. It has also given preference to proposals with aircraft affording greater passenger comfort when selecting carriers to provide essential air service in subsidy cases.

The evidence over the past five years has demonstrated that carriers will respond to passenger comfort requirements if the market can justify service with the larger aircraft affording these amenities. Commuter air carriers have expanded their fleets to include a substantial number of larger aircraft and the industry's ability to meet these marketplace requirements is improving. Furthermore, many carriers that operate smaller aircraft not affording passenger comforts of lavatories or pressurization enjoy wide-spread passenger acceptance.

Based on these circumstances, we maintain our position that there is no general need for any additional aircraft requirements. Most importantly, the majority of small communities are located a relatively short distance away from their principal community of interest for air service, *i.e.,* the nearest hub, and therefore the enroute flight time is short enough that passengers can fly comfortably without these amenities. In addition, virtually all essential air service routes operated with small aircraft are at altitudes below 10,000 feet, the altitude generally accepted as the threshold level above which pressurization is necessary for passenger comfort.

There are a few exceptions within the small communities program. Five communities in Wyoming and Montana are located over 350 miles from their designated essential air service hub, Denver, and in these cases we have required the use of fast aircraft (with cruising speeds of 250 miles per hour or more) for their essential air service. In addition, in a handful of cases, we have required the use of pressurized aircraft for routes with extended enroute times above 10,000 feet.

Aircraft with lavatories and pressurization are considerably more expensive to purchase and operate then aircraft of similar sizes without these features. Thus, a decision to require the use of such aircraft for essential air service would result in a substantial increase in subsidy. The smallest aircraft with lavatory facilities is the 17-seat Bandeirante, which is not widely used. The smallest pressurized aircraft are the Bandeirante and the 17-seat Swearingen Metro, which is currently used on many essential air services routes. However, the Metro does not have lavatory facilities. After the Bandeirante, the next smallest aircraft having both lavatory facilities and pressurization is the 30-seat Shorts 330 aircraft.

With respect to cargo requirements, the Board concluded at the time it established its essential air service guidelines that given the statutory limitations and the availability of surface transportation in most of the states, it is not necessary or permissible for the Board to consider these requirements.

As for access for handicapped persons, travel for severely disabled persons is not as convenient on smaller aircraft simply because there is less space. Our requirement for convenient cabin access by airstair door or similar type access does help to limited degree, however. Furthermore, all carriers are required by Board Regulations to assist disabled persons.

In summary, we do not recommend any changes in the current aircraft requirements for essential air service. We do not believe that there is sufficient evidence of problems that require use of larger aircraft or aircraft with additional passenger amenities that would warrant the substantial increase in subsidy requirements.

Question. Losses due to fare wars on major routes have in many cases resulted in increased fare costs to rural passengers attempting to get to hub cities. This results in forcing passengers to drive to hubs, depresses small community air passenger loads further and increases subsidy requirements of the Essential Air Service locations. What can be done to resolve this disparity?

Answer. The premise that the fares charged or losses experienced on major routes has any significant relationship to the fares charged in rural markets is incorrect.

In the first place, most of the rural markets are served by different airlines than serve the major routes that have experienced intense price competition. Since carriers establish their fares independently depending upon their cost structure and competitive requirements, the offering of discount fares in major markets by some carriers has no direct bearing on the fares charged by other carriers serving the rural markets. Furthermore, even where the same major carriers are serving dense long-haul and thin short-haul markets, we have no reason to believe that the latter fares are being kept high to support fare wars in the dense markets. For the most part, it is clear that dense-market low fares are coming directly out of carrier profits, as their red-ink figures of the last few years indicate. Thus, while higher fares in dense markets would benefit the established carriers, they would not benefit air travelers, urban or rural. Also, in order to make them "stick," truly low-cost carriers such as People Express and Southwest would either have to be barred from these markets altogether, or they would have to be forced to charge the same high fares, thus

eliminating their competitive advantage—and probably eliminating the airlines altogether.

From a standpoint of public interest, low fares have resulted in significant savings for all groups of travelers, including rural passengers who have benefited from the availability of discount fares at major air centers. They too travel, for the greater portion of their long-distance trips, on the low-fare flights available between major hubs. This is true whether the rural passenger chooses to travel to the nearest hub airport by ground travel or to enter the system at the local airport and connect to the low-fare flight. The elimination of low fares on flights in the major markets would thus adversely affect rural passengers just as it would urban ones.

Under the current law, airlines have unrestricted authority to set fares at any level they believe will induce travelers to use their services. In the past 4½ years this has often resulted in carriers offering deeply discounted fares in certain markets—usually the high-density markets—in order to fill seats that would otherwise not be used. Almost without exception, these fares were not made available to smaller communities because these cities simply did not have the travel volume which would generate the additional total revenue needed to justify the lower fares. It is true that this has often made it cheaper for travelers in small communities to use surface transportation to a nearby larger hub to originate their trips than it is to fly to the larger hub to make connections to flights which would take them to their destination. Passenger enplanements at some small cities have decreased. But this is not a social evil. Short-haul air travel is, after all, not necessarily "better" than surface travel. We believe that if travelers at small communities choose to drive rather then fly to their nearest major hub airport, that is a reasonable choice. The marketplace should determine it without the government altering the competitive relationship.

Should Congress wish to lower fares in thin markets regardless of the economic factors involved, it would have to underwrite a vastly larger subsidy program for small communities. In an era of budgetary restraint, we question whether would-be short-haul air travelers would be likely candidates for a major new subsidy program. This issue must be carefully distinguished from providing basic essential air service, as does the current program.

Question. Due to the air traffic controllers strike, restrictions have been placed on the aviation industry through the center and major slot program. Center slot requirements are being phased out throughout this year. However, major airport slot and flow control requirements will continue. It is not healthy to restrict the growth of any industry and this is the end result of slot requirements. Until capacity is increased, maximum productivity of available airspace with equal access to all is a must. This raises several questions.

a. What immediate short term and long term alternatives can be pursued to provide unrestricted capacity at major hubs?

b. Until restrictions can be eliminated, how can available slots be fairly allocated?

1. Is first come, first served, the best policy?

2. Should slots be sold to carriers with the risk of major carriers gaining a monopoly?

3. Should slots be allocated by lottery?

4. Should slots be allocated by priority ranking such as EAS replacement carriers first, new carrier service second, expanding carier service third, etc.?

5. Should slots that remain unused for a designated period of time be required to be returned to the pool or sold?

6. Can slots be sold to another carrier at any time?

Answer. The slot limitations have been severe contraints on airline service and competition. The limits have stifled the plans of both existing carriers and new entrants. However, as long as traffic control resources remain limited, giving carriers unlimited use of airspace would create legitimate safety concerns. Thus some allocation of slots is necessary at the moment.

The Board however, does not favor administrative allocations based on such factors as the relative needs of different routes or types of carrier, with the exception of allocations needed to provide a community's essential air service. The Board has accepted random allocation methods, such as lotteries, with carriers allowed to trade slots in order to move individual slots to the carrier best able to use them.

Our primary concern has been that the slot limitations would cut off new entry. We have urged the FAA to give some priority to new entrants, which they have done, but not to the extent that the Board would have preferred.

Senator KASSEBAUM. Thank you very much, Mr. McKinnon.

Mr. IGNATIUS.

STATEMENT OF PAUL R. IGNATIUS, PRESIDENT, AIR TRANSPORT ASSOCIATION

Mr. IGNATIUS. Thank you very much, Madam Chairman. My statement is requested for inclusion in the full record, and I will summarize it with your permission.

Senator KASSEBAUM. Thank you. That will be so done.

Mr. IGNATIUS. I should say at the outset that many of the points that I would make on behalf of our member airlines have been made already in substantial measure by both the chairman and Mr. Willis, and I think that is worth noting. Here we are 5 years after the most significant legislative change that has occurred in our industry in recent decades, and the executive, the regulatory, and the industry spokesmen are assessing this experience in substantially similar terms.

Now, it wasn't always that way. As you will recall, many airline executives initially opposed deregulation, but they very quickly parked whatever philosophical concerns may have remained and went about the business of competing in this new environment making the change from what were essentially public utilities to highly competitive, market driven businesses.

This was an enormous change. I don't know of anyone similar to this affecting any industry where the degree of change was so intense and in so foreshortened a period of time.

Now, everyone knew that there would be some problems, and we have certainly had transitional problems. But I don't suppose anybody foresaw with total clarity the length and extent of the recession, the soaring fuel prices and, of course, the illegal PATCO strike. The magnitude of these external factors makes it difficult to isolate the effects of deregulation itself, but one thing we think is clear: The airlines were able to cope with these events more effectively than if the cumbersome regulatory apparatus had still been in place.

Despite this flexibility, airline financial losses over the past several years have been very heavy as has already been pointed out, and understandably deregulation through its downward pressure on fares has been a factor.

Now, I would like if I might to review quickly four or five of the key issues that were in the minds of the committees and of the Congress at the time that the deregulation act was being discussed and eventually enacted.

First, safety. Congress insisted that there could be no diminution in the dedication to safety as the first principle of airline operation. The air carrier safety record in the years since deregulation matches the best in the history of U.S. commercial aviation.

Next, new carriers and services. The new freedom as expected has produced many new airlines. In the last 4 years certificated scheduled carriers offering passenger service have expanded from 36 to 98 of which 22 are new carriers. The remainder include former intrastate, supplemental, and commuter carriers.

Next, price competition. One of deregulation's primary objectives certainly was to have increased price competition. Congress concluded that this would not occur unless Government-imposed barriers to new market entry were removed.

Thus, the achievement of free market pricing was dependent upon free market access. While the new pricing freedom has produced some anomalies from time to time, on an overall basis it has lead to fare increases less than the increases in the Consumer Price Index. Fares could have risen 67 percent between 1978 and 1982 and remained within the CAB's benchmark, the so-called standard industry fare level, but in fact increased only by about 48 percent.

Levels of service, overall service, that is, flight departures, have increased since deregulation overall by about 4 percent. At the largest hubs the increase was 6.2 percent. At medium hubs, 14.1 percent, and at small hubs 5.8 percent. At nonhub airports where enplanements average less than 45 per day, service has declined 9.1 percent between 1978 and 1982.

Next, subsidy levels. The subsidy level for essential service has been less than what many, including I might say the Air Transport Association, thought that it might be. In fiscal 1978 subsidy outlays totaled about $74 million. In fiscal 1981 the figure reached $109 million but declined to $80 million the following year. In fiscal year 1983 the appropriation went down again to only $48.4 million, and the administration's budget for fiscal 1984 is $50.8 million.

Next, employee impact. Congress was concerned about this and included certain labor protection measures in the legislation. While there certainly have been changes at individual carriers, on an overall industry basis the employment totals seem not to have been adversely affected.

Indeed, there appears to have been a net gain in industry employment since 1977 of about 5,000 employees. Compensation has remained high with wages and benefits at major and national airlines averaging $39,000 in 1982, some 70 percent more than the average compensation of all U.S. workers.

Next, efficiency and productivity. As expected, deregulation has encouraged improved efficiency and productivity. There are various measures of this. Total available seat miles per employee increased 11.4 percent between 1978 and 1982. Fuel efficiency has increased from 20.1 revenue passenger miles per gallon to more than 25.

Next, cargo. Cargo was deregulated a year before passenger transportation, and there has been a profound change in the air cargo industry since that time. Prior to deregulation there were only 10 carriers conducting scheduled all cargo operations. By June of last year this number had grown to 109. Like passenger fares, cargo rates have also been within the usual measures that are applied. In the case of cargo the rates have been less than the wholesale price index increases.

Finally, attaining financial stability. Congress expected, after a transitional period, that the airlines' financial picture would improve. Unfortunately, this hasn't happened yet. Industry operating losses for the last 3 years have totaled $1.3 billion. That is about $1.2 million a day. With the upturn in the economy that is certainly taking place, with a lowering of jet fuel prices, a drop in prime interest rates and the cost-cutting steps that the industry has taken this year, 1983 and the years beyond offer, we believe, the possibility of sustained airline profitability.

Now, to conclude. Whatever one may think of airline deregulation, it is quite clear to us that reimposition of Federal economic regulation would be unwise and perhaps not even possible. Reregulation would negate the benefits of increased services and price competition. It would undo the route restructuring that has taken place. It would impair the use of aircraft acquired to serve these routes, and it would lessen the incentives for increased productivity. Of course, it would raise perplexing problems as to the fate of the new airlines and the new services that have come into being since deregulation.

The ultimate success of deregulation will be measured by the abilty of a competitive airline industry to achieve adequate earnings and to continue to provide the superior advantages of air transportation for passengers and shippers. This concludes my summary.

Thank you very much.

[The statement follows:]

STATEMENT OF PAUL R. IGNATIUS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, AIR TRANSPORT ASSOCIATION OF AMERICA

Madam Chairman and Members of the Committee: I am Paul R. Ignatius, President of the air Transport Association. With me is Norman J. Philion, ATA's Executive Vice President. We appear on behalf of our airline members, who constitute the major segment of the airline industry, to discuss what has happened since the airlines were deregulated.

INTRODUCTION

At the outset, it is important to recall that many airline executives opposed deregulation, believing that the extensive national air transportation system could not continue to serve broad public needs unless it remained under federal control. Additionally, concerns were expressed about loss of service, particularly to small communities, and the likelihood that the industry would eventually be concentrated in the hands of only a half-dozen or so dominant carriers.

After Congress acted, the airlines quickly adapted to the new challenges and opportunities. If any philosophical reservations remained about the wisdom of Congress' action, they were set aside in the effort to find how best to conduct airline operations and meet public needs in the new competitive environment. Perhaps no industry has ever been required to make such a profound change in so short a period of time as the U.S. airlines in shifting from heavily regulated "utilities" to highly competitive market driven business. As the Federal Aviation Administration (FAA) has stated, "the period since deregulation has been a time for experimentation and learning for the nation's air carriers."

It was widely recognized that there would be transitional problems following deregulation, and these have certainly occurred. Airline financial losses have been the highest in the industry's history and understandably, deregulation, through its downward pressure on fares, has been a factor. Moreover, the fare structure has appeared to be distorted to some travellers on short haul flights who believe the fare they pay subsidizes passengers on longer, high density routes. And in terms of employee impact, while new entrant carriers have provided new jobs, many employees at established carriers, who benefitted from the pattern of labor settlements during CAB regulation, have experienced layoffs attributable to a host of factors.

Thus, it seems fair to say that the first years of deregulation, as expected, have not been an unalloyed blessing for the airlines, their employees, or the public. The past several years have been turblent ones for the airlines not only because of deregulation's changes but also because of three unanticipated events of particular severity:

A lengthy recession which slowed the nation's economy with serious effect on a number of major industries including the airlines.

Soaring fuel prices in the period 1979–1981, which hit the newly deregulated airline industry with billions of dollars of increased costs that could not be fully recovered.

The illegal strike of the air traffic controllers in August 1981, which curtailed airline operations and revenue.

The magnitude of these external factors, of course, makes it difficult to isolate the effects of deregulation. One thing is clear, however: the management flexibility made possible by deregulation enabled the airlines to cope with these events far more quickly and effectively than if the cumbersome regulatory apparatus had still been in operation.

In the spring of 1983, the nation's economy is rebounding. Jet fuel prices have declined. And the air traffic control system is being returned to normal by the FAA on a carefully phased schedule, which places highest priority on sustained safety. Given these favorable developments, the scheduled airlines in 1983 may exceed the previous record of 317 million passengers in 1979, the first year of deregulation, and should top $5 billion in cargo revenues. The U.S. airlines will continue to account for more than 85 percent of domestic intercity public passenger miles, and will move 9 out of every 10 intercity first-class letters.

A major milestone of airline deregulation occurred on January 1, 1983, when the authority of the CAB to regulate domestic passenger fares was terminated. Thus, the airlines have had complete freedom to set domestic fares for only a few months, but in this short period numerous actions have been initiated to simplify fares in large and small markets in all parts of the nation.

The U.S. economy has been in recession for nearly half the time since the Airline Deregulation Act was adopted in October 1978. One consequence of this prolonged economic slump has been the heavy financial loss sustained by the airline industry during the past three years. In 1982, the industry had an unprecedented operating loss of $733 million, notwithstanding the fact that airline passenger traffic was higher than the previous year. In the early years of deregulation, revenues increased; capacity increased; domestic traffic increased; but financial losses also increased. Price cutting associated with deregulation contributed to these losses.

The process of domestic airline deregulation, as noted earlier, will not be fully completed until the CAB is eliminated. There is, however, enough accumulated experience since the Congress deregulated air cargo in 1977 and passenger airlines in 1978 to take stock of what has happened, and to review progress in meeting the expectations and concerns of the Congress when it freed the airlines from pervasive economic regulation.

DEREGULATION ISSUES

I. Maintenance of High Standards of Safety

Before Congress gave its final endorsement to airline deregulation, members of the Senate and House insisted that, above all else, the outstanding record of airline safety must be assured. Under no circumstances could there be a diminution in the dedication to safety as the first principle of airline operations. The FAA continues to regulate all aspects of airline safety. To maintain oversight, Congress requires an annual report on airline safety from the Secretary of Transportation, and regularly conducts hearings on safety-related matters.

The air carrier safety record in the years since deregulation, according to FAA and National Transportation Safety Board (NTSB) data, matches the best in the history of U.S. commercial aviation. This safety record included a 26-month period from October 1979 to January 1982 without a single passenger fatality in turbojet aircraft operations.

The growth of air transportation has depended upon an irrevocable commitment to the paramount goal of safety, whether in a regulated or a deregulated industry.

The safety record of the commuter carriers, now called regional airlines whose operations are vitally important in the national air transportation system, has improved so significantly that it received special recognition in the annual NTSB report for 1982.

II. Increased Competition

When Congress deregulated the airlines, it expected to see more competition among the air carriers, particularly in the pricing area, as well as new carriers and types of service. These key expectations were quickly met.

New carriers and services

Under the regulated environment, airlines operated certain routes at a loss while protected from intense competition on other more productive routes. Deregulation removed this protection, and with it the obligation for the carrier to absorb those

losses not explicitly covered by the federal subsidy program. Today, an airline is free to choose where it wishes to fly.

This new freedom, as might be expected, produced many new airlines. In the last four years, the number of certificated, scheduled carriers offering passenger service has expanded from 36 to 98, after taking into account merged, liquidated, and non-operating certificated carriers. Twenty-two of the 98 are new carriers that did not exist prior to deregulation. The remainder include former intra-state carriers, supplemental (charter) carriers, and commuters that now perform interstate scheduled service.

Since deregulation, newly certificated carriers and former local service carriers have captured larger shares of the market. Newly certificated carriers now hold about 7.8 percent of the total market, while former local service carriers have increased their share from 8.8 percent to 13.0 percent. As a result of this competition, the share of the market for the larger carriers understandably has declined.

The sharp increase in scheduled carriers has been accompanied by an increase in the size of the scheduled aircraft fleet. Since deregulation, 133 widebodies, 329 smaller jets, and 255 turbo-props have been added, while 157 of the noisier and less efficient first-generation DC-8s and 707s have been retired. The total scheduled service fleet has increased from 2,263 aircraft in 1978 to 2,823 in 1982.

Price competition

One of the primary objectives of deregulation was to achieve airline price competition. Congress concluded that this would not come about unless government-imposed barriers to new market entry were removed. Thus, the achievement of free market pricing was dependent upon free market access.

In the years immediately after deregulation, the airlines focused major attention on the route changes made possible by free market entry. A highly dynamic process has taken place whereby carriers have entered or withdrawn from routes to search out those market positions most suitable to consumer needs and carrier resources. In the process, the number of competitive markets has been substantially increased, and airline route systems made more efficient.

Although Congress did not give the airlines complete pricing freedom until January 1, 1983, the latitude provided during the transitional period enabled an increasing amount of pricing freedom, particularly in the last two years. The airline pricing practices generated widespread public attention and occasional criticism since they differed so markedly from the tightly controlled rate-making practices the public has become accustomed to over the period of the preceding 40 years.

While the new pricing freedom produced anomalies from time to time, on an overall basis it has led to average fare increases that are less than the increases in the Consumer Price Index. Fares could have risen 67 percent between 1978 to 1982 and remained within the CAB's then allowable fare benchmark, called the Standard Industry Fare Level, but in fact increased by only 48 percent.

Last year 80 percent of all coach domestic travel was on discount fares, compared with 48 percent in 1978. In 1982 the discount fare traveler received an average discount of 45 percent off normal full fare, compared with 34 percent in 1978.

The reduction in average airline fares, and the availability of many remarkable "bargains" have led millions of passengers to fly on heavily discounted routes. But some passengers have wondered why fares for shorter distances or in less populous areas seem to be disproportionately higher. The reason for this is found in the basic economics of airline operations.

First, it is important to note that the average load factor (the percentage of seats occupied) generally increases with market distance and market size. For example, the CAB reported in a December 1982 study of deregulation that in markets up to 200 miles serving 10 to 50 passengers per day, the average load factor was 44 percent. In markets over 1,500 miles, serving more than 500 passengers per day, the average load factor was 62 percent.

Carriers serving these two different markets will use different equipment and incur different costs. Because departure and landing costs are a much larger percentage of total cost on short trips with a small number of passengers, the operating costs per mile are much higher than for long haul, dense market trips. These two variables—load factor and trip distance—can make the per mile cost of providing one flight several times that of another, e.g., short haul versus long haul and thin market versus dense market.

In the light of this economic reality, more airlines have moved aggressively since deregulation to establish "hub and spoke" operations so that passengers from thinner markets could move forward on "spoke" flights to join other passengers at the "hub" who are bound for the same ultimate destination. The greater efficiency of

this type of operation helps the airline to control costs and expand services, and enables the traveler to gain access through the hub to the airline's entire system. In addition to the long established hub operations at cities such as Atlanta, Chicago, Minneapolis, and New York, new hubs since deregulation include Memphis, Pittsburgh, Charlotte, Dayton, Dallas, Denver, Cincinnati, St. Louis, and Salt Lake City, and more are certain to be formed.

Hub operations have been particularly significant for more thinly populated states. For example, the service from the Minneapolis-St. Paul hub airport to North and South Dakota has increased a combined 45 percent since 1978, according to the Official Airline Guide. Similarly, weekly service from the hub city of Charlotte, North Carolina to South Carolina has increased by 55 percent or 72 flights.

The transitional pricing period ended as of January 1 of this year. With complete freedom to establish domestic fares, the airlines will continue to compete vigorously. And, of course, as in any unregulated business, the level of competition in a given market will influence the level of prices. The new freedom must fulfill public expectations for a rational basis for airline prices and the compelling need of the airlines to avoid the heavy financial losses of the past several years and achieve adequate earnings.

III. Improving Levels of Service

Overall service (flight departures) has increased since deregulation. Between October 1978 and October 1982, notwithstanding the combined effects of the recession, high fuel costs and the controllers' strike, domestic departures overall increased by 4 percent, according to a December 1982 CAB study. At large hubs, the increase was 6.2 percent, at medium hubs 14.1 percent, and at small hubs 5.8 percent. The remaining "non-hub" airports, where passenger enplanements average less than 45 per day, have shown a decline in service of 9.1 percent between 1978 to 1982.

The reduction in non-hub service primarily is due to reductions in commuter service between small communities within a state. In 1978 for example, 15 Nevada cities received scheduled service. In 12 of these locations, some with populations of less than 2,000, the scheduled service was entirely intra-state and declined by 147 flights weekly.

On an overall basis, according to the CAB, there were 306 non-hub communities in 1978 where air service was limited to commuter airlines. Departures from these 306 non-hub communities have declined by 12 percent since deregulation.

IV. Assuring Essential Service and Reducing Subsidy Levels

Because of its concern that small communities might lose air service under deregulation, Congress included a provision for a ten-year "essential service" program and authorized funding to support it. Under the new program, known as Section 419, both certified carriers and commuters are authorized to receive subsidy for service to small communities that the CAB determined to be essential, if the only carrier available was compelled to operate at a loss. No subsidies could be provided to points not eligible under the Act or for service in excess of the "essential" level specified by the CAB.

Airline subsidy outlays for the prior Section 406 program amounted to about $74 million in fiscal year 1978. In fiscal year 1981, the total subsidy for the Section 406 and the new Section 419 programs reached a high of approximately $109 million, but declined to $80 million the following year. In fiscal year 1983, the combined appropriation went down again to a total of only $48.4 million. The Administration's budget for fiscal year 1984 proposes $50.8 million for Section 419 subsidy and nothing for Section 406. In all, the amount of the subsidy has been substantially less than what some, including the Air Transport Association, feared it might be.

V. Minimizing Impact on Employees

Another concern was the effect of deregulation on employment. As a consequence, certain labor protective measures were included in the legislation.

While there have been some changes in the levels of employment of various carriers, on an industry-wide basis employment totals seem not to have been adversely affected. In 1977, the year before the airlines were deregulated, airline employment among the Section 401 carriers—the scheduled carriers regulated by the CAB—totalled 313,800. In 1982 employment at the Section 401 carriers totalled 330,800, a gain of about 17,000, with the number of carriers in the 401 category having increased since 1977 as a result of the changes occasioned by deregulation. Since some of the new 401 carriers operated prior to deregulation as intra-state, supplemental, and commuter carriers, the net gain in industry employment since 1977 is about 5,000.

While still ahead of the pre-deregulation levels, airline employment has declined in the past two years as a result of the deep recession. The decline, however, has not been proportionately as large as in other cyclical industries such as metals and automobiles, which declined by 326,000 and 91,000 respectively, in the 1980–1982 period according to Department of Labor data. During this same two-year period, airline employment declined by about 30,000 from the peak level of 360,500 attained in 1980.

Present airline compensation is nearly 70 percent higher than the $23,000 average compensation of all U.S. industry workers. In 1982, employees of major and national airlines earned an average of $39,000 in wages and benefits, compared to $28,000 in 1978, an increase of 39 percent. In 1982, airline employee compensation was $3.7 billion more than it was in 1978. Because compensation levels are so high, the airlines, under pressure from the prolonged recession and intensified competition, have sought and, in some cases, obtained greater employee efficiency and productivity.

VI. Providing Maximum Management Flexibility

A major objective of deregulation was to replace government controls with free enterprise management.

Airline management today can make decisions based upon an assessment of market opportunities with a flexibility not possible before deregulation. As noted earlier, this new freedom has helped management to deal with unexpected crises such as the sharp rise in fuel prices, the controller's strike and the worst U.S. recession since World War II. Managers must have the freedom to manage their companies' affairs, and the deregulated airlines are no exception.

Increased management flexibility has produced:

Major route restructuring, emphasizing both hub-spoke and linear route alignments. This has allowed experimentation with routes more responsive to passenger and shipper needs and competitive responses to the initiatives of other carriers.

Pricing freedom to attract consumer demand, meet competition, and enhance needed revenue.

Utilization of aircraft that are better suited to market requirements or particular marketing strategies.

The introduction of more creative methods of financing, including new leasing arrangements and agreements with aircraft manufacturers.

New corporate entities for the purpose of entering new markets or diversifying operations.

VII. Improving Overall Efficiency and Productivity

During the deregulation debate, the point was made repeatedly that regulation inhibited efficiency because major decisions were made by the government, with a consequent lack of incentives for airline management to innovate and reduce costs.

Today, these incentives are operating in the airline industry and some of the resulting improvements have been quite dramatic. For example, total available seat miles per employee increased 11.4 percent between 1978 and 1982. Prior to deregulation, the airlines obtained 20.1 revenue passenger miles per gallon of jet fuel. In 1982, that figure had grown to 25.6 RPMs per gallon, an increase of approximately 25 percent. Airline productivity in 1982 was 2.7 percent above 1981, after declines in the two previous years, and further gains are expected in 1983. Finally, load factors have improved since deregulation from what they were in the preceding years.

With competitive pressures placing a premium on lower fuel costs and increased productivity, carriers have acquired an increasingly larger number of two-engine, two-crew aircraft. In 1978, only 20 such aircraft were delivered; in 1982, the number had grown to 66. One hundred ninety-six new two-engine aircraft have been delivered since 1978 and an additional 241 are on order for a total of 437.

VIII. Reducing Government Involvement and Government Cost

The Ford, Carter and Reagan Administrations have all emphasized the need for reduction of government size and government regulation. Air transportation has been in the forefront of this effort.

Airline cargo deregulation, beginning in 1977, and passenger deregulation, beginning in 1978, have been followed by deregulatory efforts in surface transportation, communication and other fields.

The CAB, the economic regulator of the airline industry, has declined in both size and budget since 1978 and will be eliminated no later than January 1, 1985. Some continuing CAB functions particularly for international aviation, will be transferred to other government agencies.

CAB employees numbered 758 in October 1978 and decreased to 491 in February 1983. As noted earlier, subsidy payments are lower today than they were before deregulation.

Other government savings, of course, are likely to be realized as a result of the elimination of most of the CAB's functions, but it is difficult to quantify their dollar value. For example, the involvement of the Justice, Transportation, Defense, and Commerce Departments and the Postal Service in CAB regulatory proceedings has been and will continue to be reduced.

Deregulation has also reduced airline costs as a result of the elimination of delays and associated legal expenses involved in the government's decision-making process.

IX. Deregulating Cargo

The first major transportation activity to be deregulated in the United States was the carriage of air cargo. This was accomplished in 1977, and there has been a profound competitive result.

Prior to deregulation, there were 10 Section 401 carriers conducting scheduled all-cargo operations. By June 1982, 109 carriers were certified under Section 418 for all-cargo operations.

It is noteworthy that the growth of one of the world's most profitable airlines, which specializes in movement of time-sensitive packages and documents, spurted after deregulation. The expansion of the time-sensitive small package service by all-cargo and combination carriers has been a striking air transportation development under deregulation.

In 1983, cargo revenue of U.S. carriers is expected to reach a new high of $5 billion for all types of air cargo, including U.S. mail.

Carriage of regular air freight, which has declined in recent years because of the recession, is expected to resume its historic growth patterns, with deregulation providing airlines an opportunity for new services to shippers of all types.

Airline cargo rates since deregulation have increased less than increases in the Wholesale Price Index.

X. Attaining Financial Stability

An expectation at the time of airline deregulation was that after transitional problems, financial performance of the airlines would improve. It was generally recognized that airline earnings under regulation had not been satisfactory, and that greater financial strength was needed for the long pull. Unfortunately, the expected improvement in earnings is yet to take place. As noted earlier, deregulation, through its downward pressure on fares, has been a factor. Additionally, external factors such as fuel price increases, a deep recession, and the controllers' strike have thwarted the industry's efforts to become profitable.

The operating losses of the industry, domestic and international, have totaled approximately $1.3 billion for the last three years, or about $1.2 million per day. The financial losses have been particularly severe for the larger carriers. Many medium and smaller sized carriers, on the other hand, have been profitable since deregulation, with several smaller carriers achieving record earnings.

With the upturn in the U.S. economy, a lowering of jet fuel prices, the drop in prime interest rates, and the cost-cutting steps management has taken under deregulation, the years 1983 and beyond offer the possibility of sustained airline profitability.

CONCLUSION

For four decades, government public utility regulation of the airline industry protected and helped build an integrated and comprehensive network of passenger and cargo service throughout the United States and internationally. Under regulation, air transportation by 1978 had matured to become one of the nation's leading industries.

In the half decade of airline deregulation, the air transportation network has continued to grow while offering passengers and shippers more competitive pricing and more innovative service than before. With increased management freedom, the airline industry should be in a better position to meet the growth needs of the 1980s and beyond. This growth will be achieved with continued highest priority attention to safety.

Whatever one may think of airline deregulation, is is quite clear that reimposition of federal economic regulation would be unwise and perhaps not possible. Reregulation would negate the benefits of increased services and price competition, undo the route restructuring that has occurred, impair the use of the new aircraft

acquired to serve these routes, and lessen the incentives for improved productivity. It would also raise perplexing questions as to the fate of the new airlines and new services that have come into being since deregulation.

As the nation's airlines look to a new era of growth and service, it is crucial that the government move forward with the National Airspace Plan to expand and modernize the air traffic control system. The FAA has won wide support for this Plan, and the aviation community, including the airlines, has agreed to fund it through higher user taxes. Serious capacity problems will develop in future years if the necessary appropriations are not provided.

The capacity of the nation's airport system must also be increased to meet the needs of commercial aviation and a private aviation fleet that is expected to add another 100,000 aircraft in the next 10 years, a 50 percent increase.

Finally, the ultimate success of deregulation will be measured by the ability of a competitive airline industry to achieve adequate earnings and continue to provide the superior advantages of air transportation for passengers and shippers.

This completes our testimony. We are prepared now to respond to your questions.

QUESTIONS OF SENATOR HOLLINGS AND THE ANSWERS THERETO

Question. In his testimony, Mr. Willis, from the Department of Transportation, discussed a preference for continuing under deregulation, letting competition in the airline industry continue until the economic recovery takes over, leading to improved yields. In light of continuing financial setbacks in the airline industry, how long do you think the recovery will take before the financial condition of the industry improves? In other words, how long can we wait?

Answer. The last nine months of 1983 are forecast to show airline operating profits from $800 million to $1.4 billion. This would overcome the first quarter loss of $650 million and produce an operating profit between $200-800 million for 1983, the first profitable year since 1979 and the beginning of financial recovery for the industry. With a continued recovery in the national economy, 1984 might see profit levels exceeding those of 1983.

Question. In the first quarter of 1983, interest rates were down, as was inflation and fuel prices. Still the 11 major airlines lost $567 million in operating cost. Why have the airlines continued to lose such large sums of money, when you stated that the primary culprit, the economy, has begun to turn around?

Answer. While the economy began to edge up in the first quarter of 1983, its real strength did not appear until the second quarter, when economic activity rose at three times the annul rate of the first quarter. The U.S. airline industry is expected to be profitable in the second quarter, with higher profitability in the third quarter, reflecting the growing strength of the national economy.

Question. Many industry analysts are talking of a phenomenon known as the permanent $99 fare. More precisely, they believe that because the deep discounts are so low, the traveling public may come to expect low fares, refusing to travel whenever the airlines attempt to raise them. What are your views on the possibility of such a situation occurring, and if it does, how will the airlines ever make any money?

Answer. The $99 fare was offered by a number of airlines to meet conditions that they considered to warrant an approach of this kind. The fare is not longer generally available. It is likely that under deregulation special fares will be offered by individual airlines from time to time to meet market conditions. In this sense, the airline industry is no different than any other.

Question. Much of the testimony at these hearings focused on the decline of service to smaller communities. What can you suggest to the Committee as possible avenues for ensuring that these smaller cities receive adequate service in the future? Would you favor revising the Essential Air Service program?

Answer. As pointed out in the ATA testimony, service increased at small hubs, just as it did at medium and large hubs. As reflected in the data from CAB's December 1982 study cited in the ATA's statement, however, there has been a decline in air service at the "non-hub" airports (where passenger enplanements average less than 45 per day). As further pointed out, however, the reduction in "non-hub" service is due, in large measure, to reductions in communter service between small communities within individual states. In 1978, for example, 15 Nevada cities received scheduled service. In 12 of these locations, some in close proximity to other communities with regular air service, and some with populations of less than 2,000, the service in 1978 was provided entirely on an intrastate basis. While this intrastate service has declined by 147 flights weekly, we do not believe the Essential Air Service program was intended to apply to each and every example of this kind.

Question. Mr. Ignatius, during your testimony you stated that there was some indication that airline yields are improving. Could you provide any such information on this issue for the record?

Answer. Over the past several months there has been an improving trend in airline yields. For the major carriers, domestic yields were down 10 percent in March of 1983 over March of 1982. In April, the yield were down 4.5 percent and in May 0.8 percent.

Question. Would the airline industry continue to support deregulation even if the leading indicators showed a marked improvement in the economy, while the airlines continued to show substantial losses?

Answer. In view of economic recovery and projected airline industry profitability, it is hoped this question is moot. It should be noted, however, that the airline industy was never consistently or highly profitable during its long history of public utility type economic regulation. Having now progressed through the most of the transition to deregulation under difficult circumstances, the airlines are opposed to a return to pervasive federal regulation.

Question. Much of the discussion at the first day's hearing focused on the question of safety and the effect the hundreds of millions of dollars in operating losses have had on safety. Many witnesses claimed that these losses have led to a severe deterioration in the airlines' concern for safety. Could you please comment on this issue?

Answer. The safety status of ATA member airlines is as high or higher than it has ever been and, in some important parameters, the data show continuing trends for improvment.

There is no way an airline can successfully provide the reliable service demanded by the public without a maintenance program which exceeds minimum safety standards. For example, no airline could manage the intricate timing of schedules needed to make carefully coordinated Hub and Spoke operations successful without aircraft of the highest level of safety and reliability.

Charts I and II attached, portray mechanical dispatch reliabilities of transport aircraft. Mechanical dispatch reliability refers to on-time departure performance of the aircraft. For example, if only one aircraft in 100 scheduled departures misses its departure time because of maintenance or material deficiency, the mechanical dispatch reliability would be 99 percent.

Chart I shows mechanical dispatch reliabilities for current narrow body aircraft—the 727-737, and DC-9's. These aircraft began operations in the 1963-1966 time period and are, therefore, mature from the developmental standpoint. The latest production versions contain all of the improvements resulting from long service experience. The older aircraft have been retrofitted or modified and contain those improvements required for safety. The dispatch reliabilities are stabilized at approximately 98 percent to 99 percent.

Chart II shows mechanical dispatch reliabilities for the current wide bodies. The reliabilities of these airplanes are still improving since they have not yet reached full maturity from the developmental standpoint. These airplanes will probably stabilize at reliabilities of about 98 percent.

Charts III and IV portray Service Difficulty Reports (SDR) per 1000 flight hours. The SDR's are a product of FAR 121.703 which requires operators to report on 16 types of failures, malfunctions or defects, plus any other failure, malfunction or defect which in the opinion of the operator has endangered or may endanger the safe operation of an aircraft. SDR rates like dispatch rates are important indicators of the safety status of aircraft.

Chart III shows Service Difficulty Reports per 1000 flight hours for current 727, 737 and DC-9 aircraft. These rates are stabilized because the airplanes are mature. There are no significant trends which indicate a higher rate of defects found in recent years.

Chart IV shows Service Difficulty Reports per 1000 flight hours for current wide body jets. These rates show a continuing slight downward trend which will probably level off at less than one per 1000 hours as the airplanes reach maturity.

Chart V shows engine in-flight shutdown rates for all U.S. airline jets plus a few selected points of reference for specific engines. The trend is still generally downward with no significant change over the last several years.

It is noteworthy that the 727 JT8D shutdown rate in 1982 was over 5 times better than it was in 1966 and approximately 40 times better than that for the Wright TC-18 used on the DC-7 in 1966.

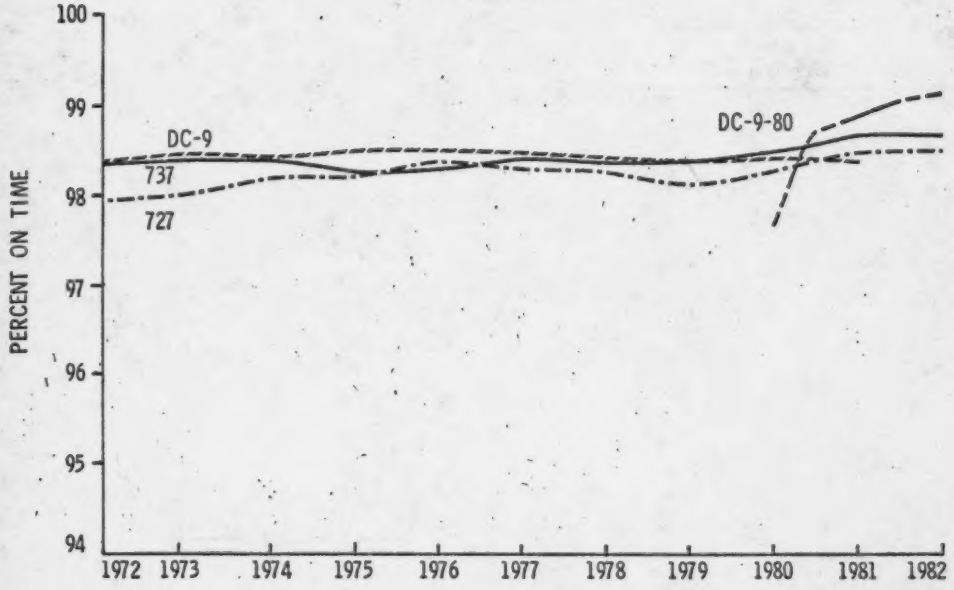
Each airline collects and analyzes many other reliability indicators than those contained in the foregoing charts. Regardless of regulatory requirements this data gathering and analysis effort is an absolute necessity for any successful airline so that it can tailor its maintenance programs to provide consistent on-time service

that is reliable and safe. It should be noted that airline maintenance programs far exceed minimum FAA safety requirements in order to meet the reliability and safety standards understandably demanded by the traveling and shipping public.

These charts show an increasing improvement in the level of reliability and safety of the aircraft over time. This occurs because of continuing improvement in the aircraft, engines and components and in maintenance programs made as a result of service experience. In some important parameters, such as engine reliability (Chart V) and in mechanical dispatch reliability (Chart I) the evidence indicates that reliability and safety are continuing to improve.

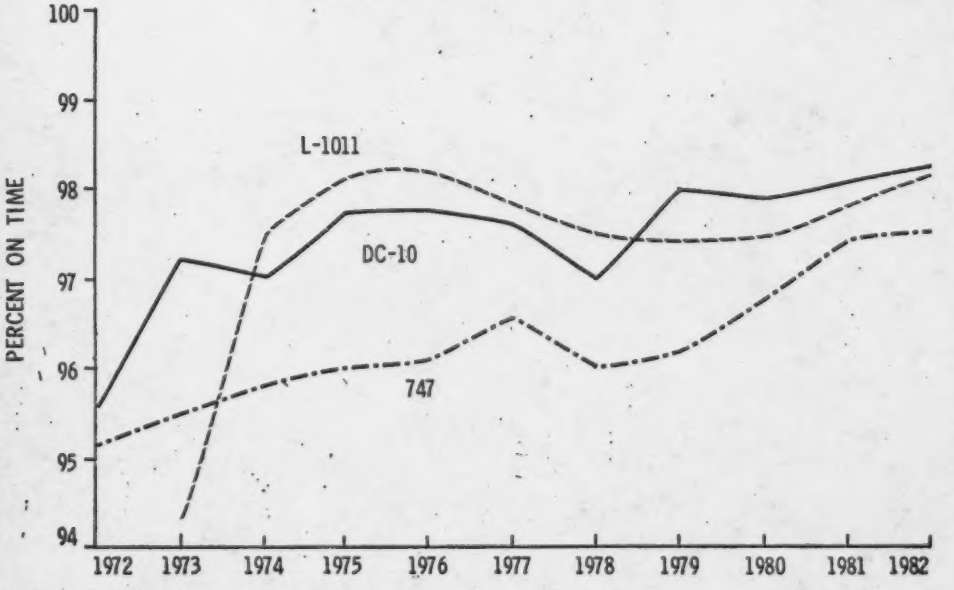
MECHANICAL DISPATCH RELIABILITY CHART I

NARROW BODIES



MECHANICAL DISPATCH RELIABILITY CHART II

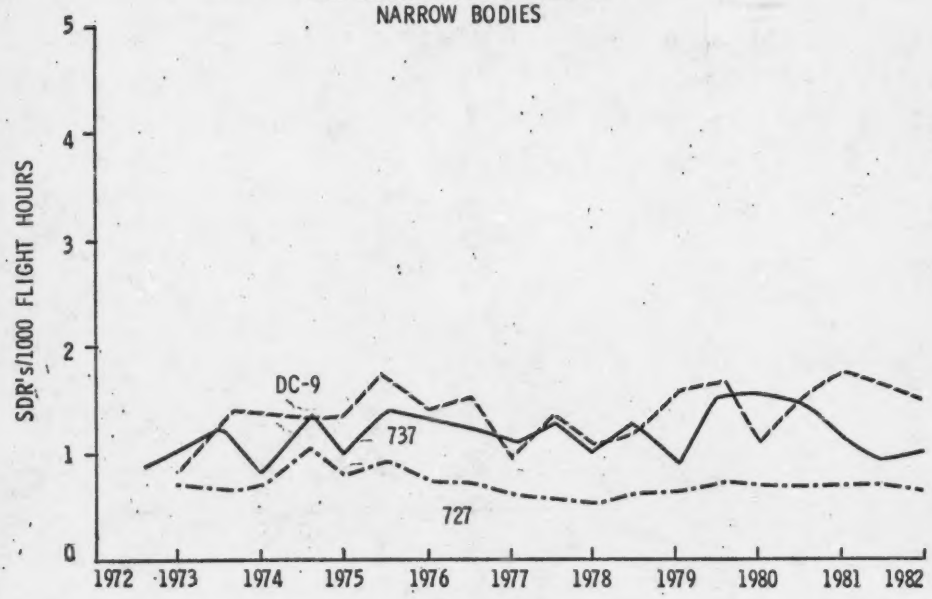
WIDE BODIES



SERVICE DIFFICULTY REPORTS

CHART III

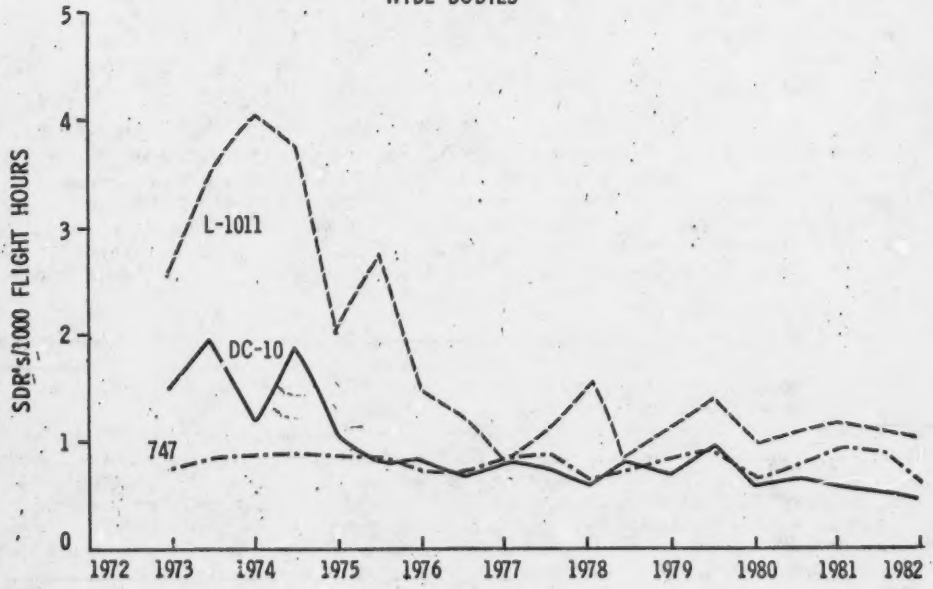
SIX-MONTH MOVING AVERAGE
NARROW BODIES



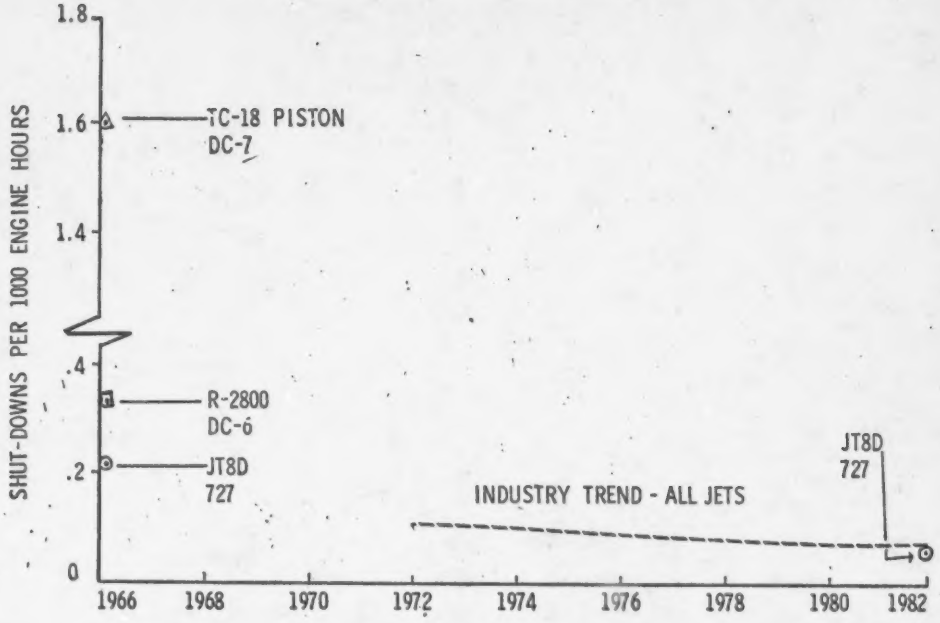
SERVICE DIFFICULTY REPORTS

CHART IV

SIX-MONTH MOVING AVERAGE
WIDE BODIES



ENGINE IN-FLIGHT SHUT-DOWN RATES CHART V



QUESTIONS OF SENATOR RIEGLE AND THE ANSWERS THERETO

Question. While it is difficult to determine poor airline performance after deregulation in 1978 due to the concurrent complicating factors of the national economic recession and air traffic controllers strike, the recession and the strike impact is easing, record revenue passengers are being carried, but poor airline financial reports and wide fare disparities exist. What can be done to resolve the remaining negative aspects of deregulation?

Answer. Airline financial prospects began to improve in the second quarter of 1983 and are expected to continue throughout the year. In 1983 the U.S. airline industry should be reporting an operating profit for the first time in four years. This improvement is expected to continue throughout 1984 as the U.S. economy strengthens.

Today there are more airline fares offered for discount than ever before and a larger degree of discounting is occurring. This phenomenon can be expected to fluctate over time as changes occur in the national economy. It can be observed that other U.S. industries, autos, for example, have experienced more discounting in recent years. Similarly, department stores have offered more goods at a discount than ever before. These industries, along with the airline industry, are likely to continue to change their discounting policies as changes occur in the U.S. business cycle.

Question. Losses due to fare wars on major routes have in many cases resulted in increased fare costs to rural passengers attempting to get to hub cities. This results in forcing passengers to drive to hubs, depresses small community air passenger loads further and increases subsidy requirements at Essential Air Service locations. What can be done to resolve this disparity?

Answer. The take-off and landing costs of aircraft operations are among the highest operating costs for an individual flight. Since they occur equally for either short of long-haul flights, they are a larger portion of short-haul costs. Thus, the per mile cost for operating short-haul distances are significantly higher than long-haul. Moreover, long-haul flights generally operate between high-density markets, and short-haul operations generally occur in connection with less populated areas. This allows a better economy of scale operation in long-haul markets and lowers the unit cost.

Under deregulation the airline industry has established a large number of hub/spoke operations. These connecting centers offer improved service adjacent to more thinly populated areas, e.g., Salt Lake City, Memphis, Charlotte, and Dayton. This has permitted passengers from smaller communities to take advantage of the full range of flights and fares available through the hub.

Question. Due to the air traffic controllers strike, restrictions have been placed on the aviation industry through the center and major slot program. Center slot requirements are being phased out through this year. However, major airport slot and flow control requirements will continue. It is not healthy to restrict the growth of any industry and this is the end result of slot requirements. Until capacity is increased, maximum productivity of available airspace with equal access to all is a must. This raises several questions.

a. What immediate short term and long term alternatives can be pursued to provide unrestricted capacity at major hubs?

b. Until restrictions can be eliminated, how can available slots be fairly allocated?

1. Is first come, first served, the best policy?

2. Should slots be sold to carriers with the risk of major carriers gaining a monopoly?

3. Should slots be allocated by lottery?

4. Should slots be allocated by priority ranking such as EAS replacement carriers first, new carrier service second, expanding carrier service third, etc.?

5. Should slots that remain unused for a designated period of time be required to be returned to the pool or sold?

6. Can slots be sold to another carrier at any time?

Answer. As announced by FAA, all center and airport slot restrictions imposed due to the air traffic controllers strike will have been removed by early 1984, with most of the remaining restrictions being withdrawn over the next several months. The final slot allocation under FAA's Interim Operations Plan has not been made and, according to FAA, the extraordinary flow control requirements associated with the plan are not expected to continue beyond next summer.

Elimination of these strike related restrictions, together with FAA's planned termination of the 1969 High Density Traffic Airport Rule, will leave Washington National Airport as the only major airport in the country still subject to slot restrictions. Such restrictions were established by the Metropolitan Washington Airports Policy, and are unrelated to the capacity of the air traffic control system. Under the circumstances, no need exists for considering or adopting nation-wide slot allocation alternatives or policies.

The primary purposes of the Airport and Airway Improvement Act of 1982 and the National Airspace Plan are to assure meeting the aviation system demands of the nation over the long term through the provision of increased airport and airway capacity. It is essential, therefore, that authorized funding levels for these Congressionally approved programs be fully appropriated and spent, as intended, from the Aviation Trust Fund which is completely financed by taxes now being collected from aviation system users.

Question. Predatory pricing is illegal and is frequently involved in the above problems. How can predatory pricing versus shrewd business pricing be clarified and enforced without re-regulation?

Answer. Predatory pricing has long been prohibited by federal antitrust law. As a result, there exists an extensive body of case law and academic literature which provides detailed guidelines on permissible pricing behavior. The airline industry is as capable as any unregulated industry in examining those guidelines and conforming to the requirements of the law. Accordingly, the vast majority of airlines believe that no special clarification of the law is necessary, and that the traditional enforcement remedies applicable to unregulated industries need no special modification for the airline industry.

Question. Fare wars and major hub to major hub routes appear to be placing many major carriers in financial jeopardy. Can reasonableness be restored to fare pricing without re-regulation?

Answer. It was anticipated that carriers would have significant adjustments to make in moving from a tightly regulated to a free market environment. Thus, deregulation was phased in over several years. During this period many factors contributed to their financial situation. However, the airlines continue to oppose any re-regulation, and are meeting the challenges with increased success. Market innovations permitted by deregulation of fares and routes are now beginning to provide improved profitability for the airlines and are expected to continue to do so.

Question. Medium size hubs without Essential Air Service protection that are located near major hubs are losing significant passenger boardings to the major hubs where drastically reduced fare ticket wars are available. This condition induces passengers to drive, increases congestion at major hubs and jeopardizes service at medium hubs. What can be done to resolve this disparity?

Answer. According to a December 1982 CAB study, between October 1978 and October 1982 domestic departures at medium hubs increased 14.1 percent. This is

larger than the increase at large hubs, 6.2 percent, and the increase at small hubs, 5.8 percent.

Question. Past practice permitted major carriers who were providing their own feeder service from smaller communities to maintain reasonable fares through subsidies and absorbing some loss, if necessary, on feeder routes to assure long route and total system profitability. After deregulation, the major airlines abandoned the feeder routes, subsidies have been reduced and mandatory joint fares eliminated. How can reasonable service and access to service be preserved for this public utility which is essential to the economic survival of lower density areas?

Answer. As noted in the question, deregulation has effectively terminated the practice of cross-subsidy, wherein an airline absorbed some of the cost of unprofitable service. Moreover, the increase in fuel costs has made it inefficient to service a small community with a large jet aircraft. However, regional and commuter airlines have generally filled the need by providing new or expanded service. As noted in the ATA testimony, departures have increased since deregulation at small and medium hubs, as well as at large hubs. It is interesting to note that in addition to the regional carriers, there are now more than 150 uncertificated commuters who account for 3.8 percent of all U.S. passenger traffic.

In the meantime, although the Airline Deregulation Act eliminated the mandate for joint fares, a wide variety of available joint fares and cooperation between the airlines and the commuters continues, and they are expected to continue in the future.

Senator KASSEBAUM. Thank you very much.

I would certainly agree, Mr. Ignatius, that I do not think there is strong support for reregulation, but there is certainly a lot of frustration in the traveling public about the wide diversity of air fares. I do not know that I think that any of you touched necessarily on that real frustration that exists in the traveling public and the belief that many have that fares in low-density areas are being held high to cover the lower fares that can be offered in the high-density markets.

I was interested, Mr. Willis, in your saying that 80 percent of the traveling public now is on discount fares. How so? I mean, I really wonder if this is part of this whole unstable situation that exists. If there is one thing all of us hear it is complaints from constituents about how they are offered three of four or five different fare levels. They are just totally frustrated in trying to shop around.

How can 80 percent of the public be on discount fares?

Mr. WILLIS. The figures we have available indicate that that is the number who do travel on a discount fare. We think it is accounted for by the fact that there is a much wider variety of offerings now than in the formally regulated system in which you tended to have a coach fare and a first class fare and relatively little else by way of discounts.

As a consequence of the increased competition that you have now, you have all kinds of carriers producing all kinds of traffic stimulating, innovative fares, and passengers are taking advantage of those. Even those who might otherwise travel on normal coach fare are finding that one or another of those discount fares can fit their travel plans, and they are doing it because they are saving money that way.

Senator KASSEBAUM. Well, let me ask you, is there some justification for the belief that the low-density markets are paying higher fares to subsidize these discount fares in high-density markets?

Mr. WILLIS. We see no evidence of that subsidy. We think, to some extent, the impression that it has happened is because in fact under the regulated system, there was a subsidy of the low-density routes by the high-density routes. As you begin to move out of reg-

ulation and as fare levels begin to more closely reflect actual costs, you would see a differential in the sense that the formerly subsidized low-density routes would now see a consequent increase and those who had enjoyed the subsidy would see deregulation as a system in which their fares are going up.

We think what is happening is simply a reflection of the actual cost of operating on those routes. As the ATA's figures and the CAB's figures show, it costs a lot more money to run a short-haul route or to run a low-density route than a high-density route.

Senator KASSEBAUM. Do you agree with that, Mr. Ignatius?

Mr. IGNATIUS. Yes, I do. First, I think that in the broad context the public had become accustomed to essentially the same fares as a result of years of regulation and the tight control over fares by the Civil Aeronautics Board. So when we were deregulated and individual carriers were in a better position than before to make their own fares, the public was confronted with a change from what they had been accustomed to.

With regard to the low-density routes and the higher density routes, there are two variables that affect the cost of serving. One is distance itself and that is obvious. You have certain fixed costs in taking off and landing and in a 100-mile flight you can't spread those fixed costs over as many miles, so the per-passenger-mile cost is greater.

But second the load factor tends to be less on the shorter haul flight than on the longer haul flight. The Civil Aeronautics Board has a study that was issued in December of last year, 1982, and they said that in markets up to 200 miles serving 10 to 50 passengers a day, the average load factor was 44 percent.

In markets over 1,500 miles serving over 500 passengers a day, that is, the long-haul market, the average load factor was 62 percent. So the per-mile cost on the longer, denser routes is substantially less than the per-mile cost on the shorter low-density routes. The order of magnitude can be 5 to 1. So there is a difference, in summary, and those differences are now being reflected more directly, as Mr. Willis pointed out, since deregulation, because in the regulated period there was a tendency to cross subsidize, that is to say, where the longer routes tended in many cases to absorb some of the costs of the shorter routes.

Mr. MCKINNON. Could I add—we have a panel discussion, Madam Chairman. A few other little things enter into this that you might want to consider. Of course, you have got the recession is one factor that has provided a tremendous overcapacity so that has provided an incentive to get into discounts to fill up those seats.

Another fact, I think, is a byproduct of deregulation has been differentials and cost structures. Under a regulated environment you had much more similar cost structures of every airline. Now, some airlines are able to operate more efficiently and since they are able to operate more efficiently they are able to cut their costs lower than other airlines and that has entered into the discount picture.

A third factor I think is imporant is peakload pricing. You may want to leave and go back to Kansas and you want to leave at a specific time. A businessman may want to go someplace and he

wants to leave at a specific time. That airplane needs to be there on demand at those prime time periods.

But to utilize that asset in other offpeak times the airlines have gone to discounts to stimulate leisure travel which is not so demanding of exactly at what time it leaves. That has accounted for a lot of the discount fares as well. So to stimulate traffic at 10 o'clock at night for utilization of that aircraft, they may offer a very low fare. However, if you want to leave at 5 in the afternoon to go home you may pay a higher price for that convenience and for the inconvenient times you get the discount. So that has also entered into it.

You also brought up about the smaller communities and the subsidy thought, and under the essential air service we oversee 570 communities that have essential air service. Not all of them are subsidized but in the process the subsidies that the Congress now pays to subsidize air service when I arrived at the CAB 2 years ago were around $114 million a year.

We are now spending roughly $48 million a year on subsidies. So to provide some of that exotic service to some of those communities, the Government was subsidizing the communities and now they are not subsidizing. People are paying what it costs them to fly.

Senator KASSEBAUM. Well, I would like to explore essential air service just a minute, but I want to go back to the fare wars again because it seems to me that with 80 percent in discount rates, that has to reflect on the financial stability of the airlines.

Mr. IGNATIUS. Well, let me comment briefly on that. The figure is correct, and the amount of the discount averages somewhere around 45 percent. So it is a deep discount that is pervasive.

What is the reason for it? I think the main reason is that we have had a period of low demand occasioned by prolonged recession. The circumstance in many other industries is similar. This has lead to a good deal of price discounting in order to try to get that marginal passenger to fly.

Now there have been a lot of changes in the last few months, Madam Chairman, that I believe and hope will have the effect of bringing greater stability. No industry can go on forever with a sale every day. You have a white sale in January and perhaps another sale in August, along with the post-Christmas sale type of thing. But if every day is sale day and every price a bargain price, that is difficult for any industry over a period of time.

There have been a number of changes, I would say, in the last few months, in part relating fares to mileage to a greater extent than before. Some of these discounts may no longer be available as some recent announcements have indicated.

I think this is all part of the assessment of the market firming up. Traffic has been good. The economy is coming back. There is a tendency then for individual airlines to assess this situation somewhat differently than they did before. So that it would seem to me that there is some stability returning. I can't get very much into pricing as an industry spokesman beyond the general observations that I've made.

Senator KASSEBAUM. You mentioned the per-mile aspect, and there are some as you know that think that the fares should be

within a specified percentage range on a per-mile basis. How do you think that would affect profitability of the airlines, and do you see that as a viable concept?

Mr. IGNATIUS. One of our airline members, a respected member, has advocated in private discussions and publicly in hearings that there perhaps be a floor and ceiling or some method that would establish a zone in which the latitute of individual carriers to price their product would be made. When we adopted positions at our March 1983 board meeting in anticipation of this hearing and other hearings, this was one of the subjects on which we needed to develop an industry position.

At that board meeting there was only one carrier that believed that there should be a return to fare regulation, and the position we adopted was on the basis of all of the others who thought that it would be a mistake for the Government to come back in to regulate in this area. So our official position is one of opposition to this. We think you ought to let the market determine this without the intervention of the Government.

And as you know, there has been a proposal by one major airline, which was followed by many others, to rationalize fares on a mileage basis.

Senator KASSEBAUM. Have they experimented with that on their own to see if it was working for them?

Mr. IGNATIUS. I don't have any knowledge about the individual carriers or the industry as a group. I think these particular fares went into effect on April 15, and we do not or at least I do not at this point have data on yields for the month of May, and obviously I don't have them for the month of June since we are still in progress.

There has been some speculation in the press, and I don't know if it is accurate or not, that there may be some improvement occurring in passenger yields. Also, I have gathered in visits to one or two of our carriers that there was the beginning of an improvement in yield. That is very important, Madam Chairman, with respect to the financial stability of the industry. That is really a very key element.

In fact, let me just show you something. This is a compilation of data on the industry that we put out every year, and in 1982, the last full year that we have, the yield was 11.8 cents per passenger mile.

The prior year 1981 it was 12.3 cents. That is to say a decline of about a half a penny. Now, if you carried the 1982 passengers at the 1981 yield, that is to say, half a penny more per passenger per mile, the effect on revenue and profit is dramatic.

So this is a very important element as you look at our industry and as you consider our situation in your oversight of the effects of deregulation. I'm dealing here only with historical data pointing out the importance of a very small improvement in yield. Looking at that historically, it would have made a significant difference as one looks at the history of 1982.

Senator KASSEBAUM. Mr. McKinnon.

Mr. MCKINNON. If you would like to just take a little different tack on this zone idea that you brought up that some people have

talked about. There is some frustration. Not everybody in a competitive environment is going to be happy.

There are people who are going to win and there is going to be a loser or two always in all competition. What would happen, I think, if you went to a zone fare structure, the smaller markets that seem to be the most frustrated would suffer even greater. The incentive would be if a carrier can only have, as one idea was proposed, a 30-percent differential between the highest fare and the lowest fare, the incentive would not be to continue to serve the small market. They have a greater volume of traffic in a higher market, and if they can only have a 30-percent fare differential, it's going to cost them more to serve those small markets because they still have to have gate employees, ticket salesmen, and all the rest. It costs them money, but they can have better utilization of those people at a larger hub. So I would submit to you if you went to that kind of a structure, you would have airlines pulling out even more of the smaller communities and they would suffer. So just the reverse of what they would like to have happen would happen.

Mr. WILLIS. And if I could add one other supplementary comment on the other side of the point that Mr. McKinnon is making and that is loss of service at small communities. There is another problem with the zone. It is not only that the carriers that have high costs would have to pull out of the smaller markets because their costs simply exceeded what they would be able to charge—the point that he is making.

But look at it from the low cost side. Our concern would be that current low cost carriers would be forced to increase their fares to get within the 30-percent band on the low side. This would be, for example, like telling People Express that by Government edict we would like to have you double all your fares everywhere. We don't see how that really meets the traveling public's desires.

Since some carriers have different cost structures than others, our feeling of the merits of the competition in a deregulated situation is that cost structures are affected by that competition. You get efficiencies and it is a consequence of your cost effectiveness. You ought to be able to pass that on to the traveling public in lower fares.

Senator KASSEBAUM. Regarding the essential air service, Chairman McKinnon, do you have any idea why ridership has dropped so dramatically. True, you point out that subsidy levels have also, but the ridership is down considerably.

There are what, 88 essential air service points now, and I would be curious why at those particular points you would believe that you see a pattern of declining ridership.

Mr. MCKINNON. Madam Chairman, if the record I think is correct, there are 570 points that were guaranteed air service when the Air Deregulation Act was passed.

Senator KASSEBAUM. But 88 that were subsidized.

Mr. MCKINNON. Yes, ma'am, and what I think you would find I would count probably three reasons why you've had a decline. One is you have a recession. There are not as many people flying any place in the United States, and that has got to affect the smaller communities as well as it does the larger communities.

Another thing that has happened is that when some airlines have pulled out, some of the bigger airlines have pulled out of the smaller communities they have served, they have still made an effort for those passengers to use them. For example, in Grand Island, Neb., when Frontier Airlines suspended service at Kearney and Hastings, Neb., they continued to serve Grand Island with jet aircraft, and there is only about 40 miles difference between those communities. So Kearney and Hastings have lost traffic, but much of that traffic has been displaced because of the merchandising of Frontier to get those same passengers to drive the 40 miles over to Grand Island. So there has been an effort in that area that also has affected the traffic from some of these smaller communities plus the recession. The PATCO strike has also affected the flexibility of some of these commuter lines to get into these big hubs as well.

Senator KASSEBAUM. Might it also be that the fares have risen far more at the smaller points compared to the industry average. How are those fares determined?

Mr. MCKINNON. Well, the fares in the small communities are determined basically on the cost of the airline to operate there under a competitive environment. If somebody thinks that the fares an airline is charging are too high, any other airline can enter that market with less costs and charge lower fares to haul people from there to somewhere else because you have free entry and you have unlimited pricing flexibility. So if it can be done cheaper, any airline is free to go to those smaller communities and institute service and charge less to do it. The mere fact that nobody is doing that indicates that those commuters are charging basically what it costs them to operate plus perhaps a little profit or what our subsidy is on top of it to keep them in business.

But what has happened was the Government had enormous subsidies in the past, and some of the people in the longer haul markets were actually subsidizing service to these smaller communities. Now in the competitive environment you are getting, everything is pretty well structured on a cost basis, and it does cost more to serve these small communities.

On the other side, living in a small community does have some benefits. You live a rural life. You have less crime. You have a lot of other pluses, clean air and those type of things, but it may cost you a little bit more to connect into the cities and have those kind of disadvantages.

Senator KASSEBAUM. Well, this is all very understandable, of course. It is just that it gets very frustrating to whether you are in Kearney, Neb., or Dodge City, Kans., as far as how you translate this into a system that is going to work with the commuter airline, the hub-spoke concept and the feeders into the hub.

I think on the other hand, as you point out very succinctly, that in the past we did highly subsidize those services and as that is changing, it is becoming more costly. However, it seems to me what we have to face is the possibility of no air service there in some of those communities at all on the basis as we have known it.

Mr. MCKINNON. Well, it has changed and what has happened under a deregulated environment, the airlines have really made more efficient use of their assets. It just doesn't make sense to send

a multimillion-dollar, very expensive 727 into a community and pick up six people.

Senator KASSEBAUM. That is not what they are doing now.

Mr. MCKINNON. No, but what they are doing now——

Senator KASSEBAUM. But still it is even more expensive.

Mr. MCKINNON. But there is no subsidy involved like there used to be.

Senator KASSEBAUM. All I am saying is people there in those communities simply cannot afford it. So it has become a vicious cycle, I mean, as the passengers decline the fares have to continue high in order to support the service in.

Now, I suppose the airline will make a decision that they simply cannot continue to serve those communities, but it seems to me that is a decision that is going to lie ahead and as you analyze the picture and as you say there is certainly declining passenger traffic. I tend to think this is tied into increased fares. For one thing, it is cheaper to drive as you pointed out to another point rather than expect that service to come in.

Mr. MCKINNON. I just submit this might be a philosophical policy issue that maybe the Congress may want to decide some day. When economics do not justify air service to a very small community, who should subsidize air service to the community? Should the Congress? Should the airlines, or should the community on an economic basis not have airline service and drive as you mentioned to a little bit larger community that can justifiably provide it?

Senator KASSEBAUM. Well, I do not know that we can subsidize it at the extraordinarily high fares that are being charged because the passengers simply are not able to utilize it.

Mr. MCKINNON. I understand your frustration, but the high cost of fares is based upon the cost of operating that aircraft and providing aircraft and if anybody can come in and do it cheaper under today's environment any other airline that can operate cheaper than the one that is operating is free to move in and provide competition to it for a lower cost. But you don't see that happening very often.

Mr. WILLIS. I just wanted to add the comment that the statistics can be a little bit tricky in this area. Certainly the idea of the essential air service program was to make sure that genuinely isolated areas had a minimum of service so that those communities participated in and we had an integrated air transportation system. To that extent, we think that the essential air service program has been well designated and well implemented to accomplish that transportation need for the isolated communities. Beyond that, you do have the question that Chairman McKinnon was touching on in his last comments and that is the number of communities that have had service where the alternative may be as little as a 26-mile drive to fly out of a small hub as opposed to flying out of that small community itself.

You have, as in his Nebraska case examples of a couple of communities, where driving 40 miles gets you to an airport and the economics of that may make more sense than to have an air transportation system that requires that instead of a hub at that airport you have planes go to each of the separate three communities—all

for the savings of a 40-mile drive for the people in those communities.

If it makes sense economically, a commuter will go in and provide that service. If it doesn't, we ask ourselves, well, should we require a system that imposes the economic inefficiencies of air service to avoid a 40-mile drive.

In that sense I think we might argue that you are not talking about a truly isolated situation. You are simply talking about a reallocation of resources that more closely match costs and for that reason, from our view, that makes a lot of sense.

Senator KASSEBAUM. Who at this point in time is really working and analyzing these problems? Is it the Department of Transportation and the Civil Aeronautics Board, or is it State by State?

Mr. WILLIS. The CAB still has the program. We, of course, are going to get it shortly. We will be working very carefully with them on it, and to the extent that we have these kind of small community concerns, concerns from the Members of Congress, we intend as a part of the process of reviewing that whole transfer to bring them into that consultation process and give it a good hard look.

But for the moment I would pass the microphone over to Chairman McKinnon.

Mr. MCKINNON. I just wanted to assure you we are every single day looking into essential air service. I think that the Congress devised an excellent program to hook a lot of small communities into the domestic air transportation system with the EAS program.

I am proud to tell you that on our staff there are John Coleman and Pat Murphy. We have two excellent men who head this up and a fine staff that works for them. I think the GAO report brought up a couple of things that were useful and something we have agreed with is that there should be some flexibility in the communities that we subsidize air service to.

As you know in 1978 we were required to provide EAS service to every community that had air service at that point in time. Some of that may be inefficient and unproductive and there may be some other communities too that we should be able to be flexible with and that our assets might be helpful to them as well.

We tried an experiment at Moab, for example, up in Utah, a very isolated area and that was under 419(b). It might be wise to have a little bit of flexibility and this is a subject you may want to visit at another time so that we have a little bit more freedom in how we handle those EAS funds.

Mr. WILLIS. If I could, Senator, make one final point that I think is useful to bear in mind and that is even under the regulated system we had some loss of service. In fact, since the Airline Deregulation Act, communities that had received certificated air service continue to receive that service.

You haven't had any loss of service in those communities. In the years of 1960 to the adoption of the Deregulation Act, 173 communities that had certificated air service lost it, so there was no guarantee under regulation.

Senator KASSEBAUM. Thank you very much. I certainly appreciate all three of you being here this morning and testifying.

I would also just like to say that there may be some questions submitted. We are going to keep the record open. Some Senators who could not be here this morning have expressed a great interest in the hearing and want to submit questions.

The next panel is Mr. Mahoney and Mr. Lindner and those accompanying. Mr. Mahoney, thank you and you might wish to introduce those who are with you at the table.

STATEMENT OF WILLIAM MAHONEY, ATTORNEY, ACCOMPANIED BY BILL SCHERI, AIRLINE COORDINATOR, INTERNATIONAL ASSOCIATION OF MACHINISTS; AND WILLIAM GILL, PRESIDENT, FLIGHT ENGINEERS INTERNATIONAL ASSOCIATION

Mr. MAHONEY. Thank you. On my immediate left is Mr. William Lindner, the international president of the Transport Workers Union who will have a short statement following mine. On my far right is Mr. William Gill the president of the Flight Engineers International Association, and on my immediate right is Mr. William Scheri, the airline coordinator of the International Association of Machinists and Aerospace Workers who are present to answer any questions which you may have regarding our testimony.

We had presented a statement of some length and with some exhibits last Monday or Tuesday, I believe, to your committee, and with your permission I will attempt to summarize those 200 or 300 pages into 5 minutes which I think I can do.

Senator KASSEBAUM: Wonderful. We need you up here testifying more often.

Mr. MAHONEY. Now the deregulation as authorized by the Deregulation Act of 1978 has, and we believe can be substantiated in citations in our testimony, injured the air transport industry. It has injured the public and it has been paid for and continues to be paid for out of the pockets of the employees of the industry and their families.

First of all, the established airlines of 1978, and that is when the act was passed, have been greviously injured by predatory competition among themselves and from a host of new entrants as was mentioned by the panel which preceeded us and that host of new entrants for the most part had nothing to lose but a few months payment on an aircraft lease when they came into this market. We have set this forth in our testimony, and I commend your attention to the Brenner report which was undertaken at the behest of Air Canada to determine whether or not they should have American-type deregulation in Canada. They decided not to.

Now, to survive, these established carriers from 1978 on have had to reorganize their operations. They have had to cut employee forces, and they have engaged in wholesale transfer of their employment forces.

They have abandoned service in one city after another by reducing the quality of that service to zero in some cases or to a most significant degree by forcing the public to ride in uncomfortable, small two engine equipment. Indeed, the "Aviation Daily" of June 21 carried a notion that the ATA senior vice president of economics and finance said that orders for three and four engine aircraft had

declined enormously while sales of two engine aircraft had increased significantly.

This was as we said thanks to deregulation and the fuel prices. Now the public does pay more for less. There is no question about it unless as was mentioned by the previous panel the public can fit into one of the myriad of cut rate schedules that are now on many routes, coast to coast routes and routes of that nature.

Eighty percent as they say ride these discount rates and these various gimmick rates that have been proposed, but the regular rates have gone up enormously in the airline industry and are completely, in our opinion at least discriminatory as appears in our testimony where we carry a chart showing this.

Now, the maintenance. When you have a problem in any business, the maintenance is the first to go in any financial crisis. In the air transport industry that is a very dangerous option to choose but there are few options available to an air carrier and when the other options are exhausted, the industry will turn to economies which will affect safety.

We have had five commercial aircraft fires earlier this month over a period of some 11 days, at least one with tragic results and a second one was very close. We had a sixth fire I think it was Saturday when a DC-9 engine burst into flames on a primary air carrier as that plane was taxiing out for a take off and the people had to exit the plane on the chutes. Some of those people—I think they said 6 or 8 people were injured.

Now think about it for a second. Before deregulation, how many times have we had those types of incidents that often that close together. It has been 5 years now since deregulation and these things tell. They are slow. They are long to come to fruition, but they do come.

Now in human terms it is the employee who has paid virtually the entire cost of the deregulation bill, and he is still paying it through reduced paychecks resulting from give back contracts which his carrier says they need in order to survive the deregulation environment. The employees are subsidizing this tragic experience in deregulation, the employees who bore the brunt of deregulation, that is the industry's 1978 work force, and that is where I think the previous panel has entirely missed the point.

It is those 1978 people who have been suffering and who we said would suffer and who have suffered. They are gone. Many of them are gone. They are the ones who suffered the changes. Sure you've got other airlines coming in and add people and that sort of thing, but it is the 1978 work force that was hurt in this case.

Now they were promised by the Senate as is pointed out at our testimony that they would be protected. They were promised by this committee in its report. They were not protected. They are not protected under section 43 of that act, and they will never be protected.

The reasons are first, the trigger mechanisms and conditions that were put into section 43 by this committee. Second, the 5-year inaction by the Department of Labor and the CAB; and finally the recent action of the CAB guaranteeing section 43 would never be activated.

This legislation has hurt this industry. It has been costly to the public, and it has been brutally indifferent to the employees. It now jeopardizes the safety of the public, we believe, and the welfare of the employees obviously and it should be amended and it must be amended.

Thank you very much.

[The statement follows:]

STATEMENT OF BROTHERHOOD OF RAILWAY AND AIRLINE CLERKS, FLIGHT ENGINEERS INTERNATIONAL ASSOCIATION, INTERNATIONAL ASSOCIATION OF MACHINISTS AND AEROSPACE WORKERS, AND TRANSPORT WORKERS UNION OF AMERICA

Madam Chairman and Members of the Subcommittee: My name is William G. Mahoney. I am a lawyer with the firm of Highsaw & Mahoney, P.C., with offices in Washington, D.C. I am appearing today on behalf of the Brotherhood of Railway and Airline Clerks, the Flight Engineers International Association, the International Association of Machinists and Aerospace Workers, and the Transport Workers Union of America. On behalf of these unions and the many tens of thousands of employees represented by them in all crafts and classes on this nation's air carriers, we express to you our appreciation for this opportunity to present the devastating and tragic effects which the implementation of the provisions of the Airline Deregulation Act of 1978 has had upon them and their families.

The labor organizations in the air transport industry always have been and will continue to be supportive of any plan to encourage the development of an air transport system which would adequately serve the present and future needs of this country. What these organizations cannot do is lend support to a plan or policy which severely and unjustly affects the employees who keep the industry safe and operational. The views which we express today are based upon our daily experiences in this industry since the enactment of the Deregulation Act and the utter worthlessness of Section 43 of that Act as a source of employee protection. Virtually every prediction made by these unions in their pre-Act testimony has come to pass, including the need for and lack of employee protection contained in the bill which became the law.

Labor opposed the deregulation move from its inception because of its many anti-public interest aspects. We suggested in 1978 that Congress be guided by the consistently most unsatisfactory history of unregulated transportation modes and reject deregulation of the air transport industry. We predicted that should Congress allow the economic forces of the market place to have free rein in the air transport industry, the system, the employees, and the public would suffer; and they have suffered. The proponents of deregulation are fortunate indeed that fuel prices increased, the striking air traffic controllers were locked out, a recession occurred, and DC-10s were grounded for awhile. But had only one of these events occurred, those proponents of deregulation would be heard to claim that it, and not deregulation, was the cause of all the ills visited upon the air transport system, its employees and the public since 1978.

In the five years after its enactment, the devastating impact of airline deregulation has become clear. Immediately prior to deregulation, the International Association of Machinists and Aerospace Workers (IAM) represented 83,976 air industry employees; that number today has dwindled to 70,049. The Transport Workers Union (TWU) before deregulation had 32,900 members associated with the air transport industry; that figure has dropped to 28,600. In those two groups alone, approximately 14,000 employees have been furloughed since deregulation. Unfortunately, Labor does not believe that the full force and effect of deregulation has been felt. While there have been these tremendous reductions in employment ranks, Labor fears that the past and current experiences may just represent the tip of the iceberg.

Airlines, for the most part, are subject to the same fuel costs, the same landing fees, the same interest rates. The only economic areas which provide cost reduction potential are those involving service and labor expenses. Service generally would not be selected as an area to cut expenses because of the detrimental impact it would have on competitiveness. Labor, therefore, has suffered great blows as carriers vie to survive.

The sole effect of deregulation, however, has not been felt in employee dismissals. For example, 1,500 TWU American Airline employees have been forced to relocate in order to retain their jobs. In many cases, these employees were forced to sell their homes with low interest rate mortgages in order to buy homes at greatly in-

flated prices and interest rates. Situations have arisen where an employee who relocated shortly thereafter was required again to relocate or lose his job. Although employees are demanding job protection in collective bargaining negotiations to abate these problems, they have received no protection packages. In fact, the carriers, rather than creating protective benefits, are seeking wage cuts, wage freezes, and greater productivity from the employees.

The effects of deregulation, besides injuring the employees, has harmed and will continue to harm the public. TWA, for example, has reduced several major stations from ½ to ¾ of their original size, while at the same time practically doubling the number of new cities it now services. The employees who remain are overworked, which, of course, must impact on the safety of the industry.

Deregulation, however, already has endangered the safety of the industry. Some carriers now down play safety to cut costs. American Airlines, in April 1983, instituted a change in its long-established maintenance inspection procedures. American used to require flights operating through Class I Maintenance Stations to be checked for airworthiness prior to departure. The new policy, however, does not allow for these inspections; rather, machanics now will not inspect aircraft until an actual failure of an aircraft system or component occurs. Safety should not be an area for curbing costs, yet predatory competition in the industry brought on by deregulation has forced carriers to find methods for reducing expenses. Unfortunately, those cost-cutting efforts have been sanctioned by the Federal Aviation Administration (FAA). In a June 10, 1983 letter to an official of the TWU, Roger G. Knight, Manager of the FAA's Flight Standards Division, attempted to justify American's change of maintenance procedures. Because American has operated through Class II stations for years "without any identifiable negative effect on the air worthiness of their aircraft," Mr. Knight believed that American's new maintenance proposal would not decreass the safety of American's operations. A copy of Mr. Knight's letter is attached to this testimony as Attachment 1.[1] Responding to Mr. Knight's contentions, John Kerrigan of the TWU, in correspondence dated June 16, 1983 (which is attached to this testimony as Attachment 2), brought to the FAA's attention that:

(1) Under past procedures, American's aircraft transiting or originating in Class II stations would at some point in their scheduled operations be inspected by licensed mechanics at Class I stations, usually within the same day.

(2) American's previous maintenance procedures provided that, since many aircraft transition a Class I maintenance station would continue flight legs through a succession of nonmaintenance stations, maintenance personnel should endeavor to correct logbook discrepancies at every available opportunity.

(3) Maintenance personnel prior to the policy change were required to inquire whether certain items needed repair or whether certain maintenance action was necessary. Additionally, a general walk-around check was required to assure serviceability. These "transit" checks are no longer performed by licensed aircraft mechanics.

By approving American's new maintenance policy, the FAA is not fulfilling its statutory duty to protect and ensure the safety of the industry. Congress, through the passage of the Deregulation Act, has permitted carriers and the FAA to shirk their responsibility to the public. Labor submits that Congress should immediately take a stand to remind to the carriers and the FAA of their obligation to safeguard the interest of the public.

Further endangering the safety of the industry are the newcomers to the industry. Proponents of deregulation use these newcomers to illustrate the success of deregulation. While these new carriers often offer lower fares, they have little or no investment in real estate, training or safety features.

Deregulation has allowed the conception of these carriers which frequently operate with the rejected aircarft of other carriers. Their equipment, in conjunction with their maintenance programs, leaves much to be desired for the flying public. It is true that they may be able to trim prices, but in order to do so, they have also trimmed their labor and maintenance costs. Surely, it was not the intent of the Congress in passing the Deregulation Act to encourage the growth of carriers with questionable safety reputations.

Safety simply is not an area for carriers to exploit in order to reduce their overall expenses. Yet other interested groups besides Labor recognize that this trend is occurring.

An official of the National Transportation Safety Board testifed before the Senate Transportation Appropriations Subcommittee this year and stated that financially

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[1] The attachments referred to in this statement have been retained in the committee files.

distressed commuter carriers have a tendency to overlook and short circuit Federal safety provisions in order to cut costs. Recently, the Federal Aviation Administration withdrew its proposal to allow the industry to develop its own safety regulations. Labor submits that the FAA's reaction was an acknowledgement that after the numerous airplane fires in early June, the safety of the industry cannot be further jeopardized.

Electrical fires on Air Canada and United planes *during* flight should serve as a warning to all of us. Safety cannot take a back seat to profits, yet Congress has encouraged that type of management attitude by the enactment of the Deregulation Act. Before other lives are lost or tragically affected, Congress should reexamine the purported benefits of the free enterprise philosophy in the air industry arena. By bringing deregulation to an end. Congress will be shifting the emphasis back to where it belongs: providing high quality and safe service to the traveling public.

From the above discussion, one could certainly understand the employees' disenchantment, if not bitterness, with the Deregulation Act. Labor, as noted above, does not stand alone in its awareness of the less-than-positive results of the deregulation of the air transport industry. We have compiled some excerpts from the publication, Aviation Daily. These items span the years 1979 to the present and deal primarily with the severely adverse economics and service effects of the Act. The following are merely some of the items which have appeared in Aviation Daily which we have attached to this testimony with the permission of the editor as Attachment 3:

January 16, 1980—Analysts Cite Deregulation As Cause of Lower Airline Profits.

An airline analyst last week named deregulation, not fuel, as the primary cause of the airlines poorer profit performance. David Campbell, senior VP-institutional sales of Wheat, First Securities, Inc. said deregulation has brought about 'an almost indiscriminate expansion of routes' . . . . Campbell said route expansion 'has cost the carriers plenty in terms of additional personnel, terminals and lowload factors. Ultimately, this will be corrected when carriers begin to drop routes. In the meantime, the consumer must pay the price'. . . .

January 18, 1980—Banker Says Deregulation Contributes To Airlines Financial Problems.

Deregulation, and the subsequent liberal philosophy of CAB, have helped contribute to the financial problems of the U.S. airline industry by fostering competition and lower fares to attract traffic during a period of spiraling costs and a backsliding economy, according to Frederick Bradley Jr., VP of Citibank of North America . . . .

Bradley, a leading authority on aircraft financing, said inability of airlines to institute fare increases sufficiently high to counter soaring fuel costs and reduced traffic is a direct product of deregulation and CAB's current philosophy. . . .

October 31, 1980—Economist Says Deregulation Not Meant For Aviation Industry.

Economist John Kenneth Galbraith told the IATA Annual General Meeting that the airlines cannot function without regulation and that the industry 'never qualified as an ideal prospect for the unregulated market.' . . . Galbraith concluded that in industries like aviation, 'regulation can be good or bad, burdensome or less so, but . . . it cannot be avoided'. . . .

December 9, 1980—DOT Study Shows Service Loss At Most Airports Since Deregulation.

Although scheduled air service within the continental U.S. has increased overall since deregulation, more than 40 percent of the nation's 465 certificated airports have lost service in terms of weekly departures, and nearly 60 percent of them have lost service in terms of weekly available seats, according to a Department of Transportation study. . . .

June 9, 1981—Senator Pressler Says U.S. Will Regret Deregulation Act.

Senator Larry Pressler (R-S.D.) charged last week that airline deregulation is threatening to cripple the industry and that the U.S. is 'going to live to regret the airline deregulation bill in terms of our national policy.' . . .

February 1, 1982—Free Market Conditions Are Not For Airlines, Consultant Believes.

Melvin Brenner . . ., a former VP-marketing at TWA and American, said deregulation, contrary to prevailing beliefs, has inflated fares since its passage in 1978, and has created 'nightmare' financial problems for the industry . . . 'Efforts to blame all this on fuel prices and recession alone stretch credibility,' . . .

August 6, 1982—Deregulation Adds To Instability of Industry, Analyst Says

Edmund Greenslet, VP for Merrill Lynch, calculated for three separate five-year intervals the range of operating margins for the individual airlines and their average operating margins for the same time span . . . This conclusion that deregulation has increased instability and exacerbated the up-and-down earnings nature of

the industry was founded on a belief that prices now act to intensify cyclical traffic patterns rather than moderate them as was the case under regulation. In those days, when traffic fell, so did the rate of return. Therefore the industry tended to obtain fare increases at the recession trough and this offset in financial terms, the revenue decline caused by falling traffic. Since deregulation, however, lower traffic induces more carriers to marginally price more of the product to fill empty seats, so prices and traffic fall in concert. The result is a more intense revenue decline, and thus wider margin swings. . . .

There are, of course, proponents of deregulation who will tell you that it has succeeded. In testimony before the Aviation Subcommittee of the House Public Works and Transportation Committee, Paul Ignatius, President of the Air Transport Association contended that employment totals among the Section 401 carriers have increased since 1977. While labor wishes that Mr. Ignatius' allegations were accurate, his figures are contradicted by the CAB's findings on employment in the industry.

On page 10 of the April 1983 CAB order attached to this testimony is a chart which details the number of employees of certificated carriers from October 1978 through December 1982. This compilation is significant not only because it flatly rebuts the ATA's claims, and shows an overall decline in employment since October 1978, but because the CAB figures also illustrate a very disturbing trent in active employment in the industry since deregulation. The CAB figures indicate that the number of full time employees decreased during the period October 1978–December 1982, while the part-time employee totals have risen slightly during this same period. This change in hiring practices is of serious concern to employees who require full-time employment opportunities to support themselves and their families.

Labor has repeatedly emphasized that the effects of deregulation cannot be determined simply from a gleaning of statistical evidence. The CAB statistics illustrate only that overall employment levels in the entire industry have declined by approximately 6 percent. These statistics do not show the many employees who lost their jobs because they couldn't move to new jobs and were replaced by new employees; not do they indicate the thousands of 1978 carrier jobs that have been replaced by thousands of jobs with different people on new carriers. Loss of employment which followed the Brainiff and Air New England insolvencies demonstrate the shortcomings of dependence on overall statistics. The air transport industry is comprised of people, not numbers, and even according to the CAB at least 40,000 people since December 1979 have lost their full-time jobs. But a great many of the people who are employed in December 1982 are not the same employees who were part of the October 1978 calculation. These overall figures are an inaccurate gauge of the real effects of deregulation upon the employees working in the industry in October 1978.

While one would hope that the CAB would look at the effects of deregulation with an impartial eye, the Chairman of the CAB, Dan McKinnon, in his recent testimony before the House Aviation Subcommittee, demonstrated once again that he is one of deregulation's avid supporters. Obviously, Labor does not share Chairman McKinnon's enthusiasm for deregulation, nor does it find persuasive his many praises.

As he recognizes in his statement, one of the most frequent complaints about deregulation is that passengers in one market subsidize passengers in other markets. While the Chairman offers some explanation for these fare discrepancies, Labor still questions the reasons for these price differentials.

On June 14, 1983, my office made telephone calls to various airlines to determine how much it would cost to fly first class and coach to selected cities on June 20, 1983. The following tabulation of this research reflects one-way ticket prices from Washington, D.C.

City	Miles from Washington	First class	Cost per mile	Coach	Cost per mile	Carrier
New York	229	161.00	0.70	65.00	0.28	Eastern.
Detroit	385	182.00	.47	142.00	.36	Northwest.
Boston	414	164.00	.39	139.00	.33	Northwest.
Atlanta	532	206.00	.38	172.00	.32	US Air.
Chicago	590	334.00	.56	228.00	.38	United.
Milwaukee	634	254.00	.40	198.00	.31	Northwest.
Miami	919	299.00	.32	249.00	.27	Eastern.
Kansas City	927	275.00	.29	212.00	.22	Northwest.
New Orleans	969	317.00	.32	264.00	.27	Eastern.
Houston	1189	361.00	.30	301.00	.25	Eastern.
Phoenix	1956	486.00	.24	405.00	.20	American.
Las Vegas	2077	461.00	.22	410.00	.19	American.

City	Miles from Washington	First class	Cost per mile	Coach	Cost per mile	Carrier
Los Angeles	2288	539.00	.23	395.00	.17	American.
Seattle	2307	428.00	.18	345.00	.14	Northwest.
San Francisco	2419	539.00	.22	419.00	.17	United.

A review of this chart illustrates that passengers flying to Chicago, which is 590 miles from Washington, pay more than passengers flying to Milwaukee (634 miles), and New Orleans (969 miles). It is also interesting to note that passengers travelling to Seattle (2307 miles) pay only a little more than two times as much as someone would pay to fly to Detroit, although Seattle is six times farther from Washington than Detroit.

These calls also highlighted the price competition among the carriers. Costs to Chicago depend not only on your choice of seating but also on the carrier you choose. On United, American and TWA, it would cost $334.00 (one way) to fly first class, on Northwest your charge would be $244.00. Coach seating ranges from $141.00 (Northwest) to $228.00 (United). Chairman McKinnon attributes differences in fares to such factors as: (1) the higher cost of service to smaller markets; and (2) the reduced demand in many long-haul markets. However, those reasons do not explain why Northwest charges $90.00 less than United for first class and $87.00 less for coach. Cross-subsidization and the economics of charging what the market will bear, Labor believes, explain those cost differences.

Supporters of deregulation point to the decrease in fares which have arisen since 1978. However, fares on a whole have fluctuated more radically since the institution of deregulation. Exceptionally low fares often are for the benefit of vacationers since those fares are usually offered only on glamour routes. Deregulation has been a boon for those who wish to fly coast-to-coast on certain carriers. The majority of air travel, however, does not revolve around pleasure trips from Los Angeles to Washington.

Other low fares result from the fare wars which grow out of the temptation of entering a market for the purpose of using idle equipment. Since the purpose of starting this service is to avoid the non-utilization of aircraft, the new entrant, to attract some part of the market, will offer low fares to recoup a part of its costs. Established carriers then are obligated to either respond to those low fares or be forced out of the market.

Regardless of how palatable one tries to make deregulation, Labor believes that most of the public realizes that under deregulation, service has deteriorated. Whether one talks about the spacing between the seats, the quality of airline food, the frequency of flights, the proliferation of small, two-engine equipment, the cities one cannot fly into, or the cities one cannot travel to and depart from on the same business day, the end result is the same: quality of service has deteriorated to a significant and serious extent. Also, that business obtained from the segment of the public which turned to air travel after the start of jet service will be lost when those individuals once again are compelled to fly on turbo-prop communter planes to reach their destination. Deregulation has failed the traveling public.

Deregulation supposedly was to lead to more efficient and economical service. However, we believe it reasonable to ask how economical and efficient can it be to have seven airlines. criss-crossing from one coast to another with half empty wide-bodied aircraft? The only group which conceivably benefits from such service is the one which supplies the fuel to the airlines.

Now is an appropriate time to reflect on the relative merits of deregulation after its five years of existence. When it was porposed, its supporters were full of accolades. The supporters' expectations, however, have not been achieved.

Richard J. Ferris testified before the Congress in 1977 in his position as President of United Airlines. Mr. Ferris, on behalf of United, advocated regulatory reform. In his testimony, Mr. Ferris recognized that the United States air transportation system provided the finest service with the finest equipment at reasonable prices. As his rationale for changing such a successful system, Mr. Ferris conjectured that without reform, the ability to sustain the system would be jeopardized. Ironically, after the passage of the Deregulation Act, United now finds itself in financial trouble.

United, in 1978, was in first place among the trunk airlines in profitability as measured by operating profits. After the passage of the Deregulation Act, United requested authority for several new routes that would have been impossible to obtain before the enactment of the Act. Expecting continued success, United ordered

65 new planes in 1978. Unfortunately, 1979 brought United a net loss of $99.6 million. Even with this loss of revenue, United continued to reconfigure its system. The CAB granted United 35 new routes in 1979; on the other side of the coin, United terminated all service in 12 cities. Approximately 500 employees were furloughed as United adjusted its schedules.

In 1980, United suffered its second consecutive unprofitable year with a $15 million net loss. United, therefore, once again adjusted its capacity to meet what it perceived to be market demand. Several routes were terminated or reduced, while service to six new cities was initiated. By December 31, 1980, United had 4,633 fewer employees than in December 1979.

1981 brought about no change in this trend. United reported a net loss of $104.4 million, which it attributed in its 1981 Annual Report to "chaotic" competitive conditions in the deregulated environment. At the close of 1981, United reduced its employment by an additional 4,296 employees.

In its April 1983 order, the CAB determined that 1982 had also resulted in major contractions (reductions of at least 7½ percent in employee levels) for United for the months January-June 1982. Deregulation, it appears, did not provide the impetus United had envisioned.

Merrill Lynch in a May 20, 1977 Institutional Report drew some conclusions about the predicted effects of deregulation. It quantified its evaluation of trunk carriers' ability to thrive or survive in a changed environment by ranking 11 trunk carriers, from the strongest to the weakest.

1. Delta; 2. Northwest; 3. Braniff; 4. Continental; 5. National; 6. United; 7. Western; 8. American; 9. Pan American; 10. Eastern; and 11. TWA.

Merrill Lynch's predictions were not quite on the mark. Since then, Braniff, ranked third strongest, has ceased operations and has filed for reorganization under the bankruptcy laws. Continental, which shared fourth place with National, underwent extreme financial hardships in the deregulated economic climate.

Continental, until the passage of the Deregulation Act, had consistently operated at a net profit, with one exception in 1975. Continental's financial results have plummeted, however, since 1978, with recorded losses of over $13 million, $20 million, and $60 million, respectively, for the years 1979–1981. Losses since 1981 have been in the $40–55 million dollar range.

Under the open entry—open exit policy of the Deregulation Act, Continental pursued an aggressive route restructuring campaign. In 1979, Continental added 15 new route segments on the Mainland. 13 new routes were added in 1980 while 9 existing routes were terminated. Continental recognized that deregulation was contributing to its financial woes in its 1981 Form 10–K filed with the SEC; it continued, however, its practice of route expansion in 1981 by adding 15 new routes to its system.

In 1978 Continental had 12,784 employees. That figure rose to 13,054 in 1979 as Continental carried out its expansion program. Over 3,500 employees were furloughed in 1980 as Continental faced its economic realities. An increase in employment occurred in early 1981; however, by the end of 1981, Continental had again reduced the number of its employees, while also requesting from employees pay cuts and/or wage freezes.

While Continental's acquisition by Texas International offered some relief, the CAB in April 1983 nonetheless found that Continental again had suffered major contractions from March–August 1982.

National merged into the Pan American system, and that carrier totters on the brink of bankruptcy. American, Pan American, and TWA have also experienced major contractions under Section 43 of the Deregulation Act. It appears that few, if any, of these carriers are thriving under deregulation, and the employees suffer first and most severely with their employer under this current scheme.

In 1981, the Survey and Investigations Staff of the House Appropriations Committee reported to the full committee on the changes in airline service and fares. Many of the observations are worthy of attention. At the time of the study, the staff indicated that since deregulation, air fare increases had exceeded airline costs and the consumer price index. Partly responsible for those high costs, the staff opined, was deregulation.

Airline managers were experimenting to find effective means of operating in a competitive environment. They did not adequately assess the impact of penetrating new markets in an unregulated environment. Management also misjudged the consequences of excess service capacity developing in the longhaul markets, as a result of aggressive carrier competition, coupled with declining consumer demand for air service.

Notwithstanding, the 56-percent rise in airline operating costs does not fully explain the 84-percent surge in fare prices. It is quite possible that one of the reasons

the airlines increased fares more than the rate of cost increases was to compensate for the declining passenger volume.

A Report on the Efforts To Close Down Operations of the Civil Aeronautics Board and Changes in Airline Service and Fares, September 1981 at 19.

Perhaps the most extensive study on this subject was prepared by the Melvin A. Brenner Associates, Inc. in 1981. Commissioned by Air Canada to study the effects of airline deregulation in the United States, Brenner Associates compiled a study which concluded that deregulation had detrimentally affected U.S. air service. In its summary of findings, Brenner Associates submitted an unabashedly critical account of the lack of success of airline deregulation.

Competition has greatly increased on the more attractive routes, while service has deteriorated on many of the smaller, and shorter haul routes, according to Brenner. To illustrate the imbalances in these services, Brenner computed that seat capacity increased 25 percent at the large leisure-related airports, but decreased 8 percent at smaller airports. Seat capacity on long-haul routes climbed 30–60 percent but declined 20 percent on short-haul routes. This situation was not predicted to improve.

The public, on a whole, has not benefitted from the fare changes. Benefits which have been derived have resulted from price wars rather than "economically supported reflections of improved efficiency." On a route-by-route basis, there have been tremendous fare disparites since deregulation. The unrestricted coach fare on many non-glamour routes, at the time of the study, had doubled. These increases were required to offset the uneconomic "bargains" on other routes.

As pointed out by Brenner, deregulation has had a disastrous effect on airline earnings. The first full year of deregulation was one of the worst financial years in airline history; the second year (1980) brought about the all-time record loss for the industry. Deregulation was a major cause, if not indeed the major cuase, of these serious financial results; they cannot be explained away by the recession, DC–10 groundings, the PATCO strike and lockout, or fuel prices.

1978–1980 was not the first time the industry confronted a sudden major jump in fuel prices. In 1974, fuel prices rose 76 percent. With regulation, however, Brenner noted that it was possible to adapt to new circumstances, with measures such as capacity agreements. While recognizing that the recession had an impact on carrier profits, Brenner stated that airline earnings began to drop in the very first quarter in which deregulation was enacted. That preceded by approximately 6 months the date on which fuel prices suddenly escalated. In terms of the necessary effects, airline earnings began to slide almost a full year before the recession caused any material slowing down of traffic.

To illustrate this downward slide in earnings, we have attached to this testimony as Attachment 4 two (2) charts taken from Aviation Daily. These tables in the March 1 and May 4, 1983, editions demonstrate that deregulation simply is not working. The following sets forth the net profits or losses of the major carriers since 1981:

[In thousands]

	12 months 1981	12 months 1982	4th quarter 1982	1st quarter 1983
American	2,289	−53,443	3,448	−28,100
Continental	−43,469	−41,800	−11,300	−57,628
Delta	91,640	−17,058	−5,600	−39,480
Eastern	−65,877	−74,927	12,201	−60,700
Northwest	10,460	5,019	−2,570	−20,905
Pan Am	−414,286	−492,569	−275,610	−79,600
Republic	−46,269	−39,861	−27,324	−58,982
TWA	−28,268	−44,474	−24,700	−92,743
United	−104,368	2,238	39,148	−94,551
USAir	51,084	59,104	12,048	−1,912
Western	−73,400	−44,000	−39,600	−17,800

The IAM studied the effects of decreased profitability on employment levels, and its analyses, which are attached hereto as Attachment 5, show that a decline in employment is a corollary to a decline in profits. As the major carriers' financial pictures worsen, primarily because of deregulation, employment in the industry will continue to decline.

Robert Crandall, Acting Director of the Council on Wage and Price Stability, in March 1977 presented his arguments in favor of deregulation. In dismissing the concerns of critics of deregulation, Mr. Crandall said there was "no need to fear volatile pricing, excess capacity, or a wave of airline bankruptcies." Yet, we are experiencing today a perplexing, and volatile, pricing system, excess capacity, and the prospect of more air carrier insolvencies.

We also appear here today to recount to you how the passage of the Deregulation Act has seriously affected the air carrier employees. These organizations testified many times before this and other committees of the Congress as to the obvious effects which would result to employees of this industry following enactment of deregulation legislation. It was decided by both the Senate and the House that protection against those effects should be provided for employees; however, the protection package suggested by the Senate and ultimately enacted into law, with its many triggers, conditions, and dependence upon the future actions of several agencies, has not achieved its goal. Not one of the thousands of employees who have suffered serious economic injuries because of deregulation has yet received any protection. Indeed, the term "employee protection" in relation to the Deregulation Act can be viewed at best as a cruel hoax upon the employees of the air transport industry.

Because Congress recognized that airline employees would be adversely impacted due to the passage of the Deregulation Act, Congress devised a limited employee protection program. To fully comprehend how severely limited that program became an overview of the history of the current protection program is necessary. In 1978, when Congress earnestly began to consider the deregulation of the airline industry, various pieces of legislation were introduced to amend the Federal Aviation Act of 1958. The House, in H.R. 11145, originally devised a scheme which called for no form of protection for airline employees affected by deregulation. Recognizing the serious void created by that action, the House proposed legislation to include such employee protection in H.R. 12611. The form of protection contained in H.R. 12611 would have resulted in protections similar to those afforded railroad employees adversely affected by rail carrier actions. For instance, the House-designed protective scheme would have permitted no changes in employment until an implementing agreement between the carrier and the union was executed. Fringe benefits for airline employees would have been unaffected. Employees whose jobs were abolished would have been accorded dismissal or displacement allowances for up to a 6 year period, depending upon the employee's length of service. Retraining and relocation expenses would have been covered. While this legislation was unique in the airline industry in that it both mandated protective benefits and updated the levels of protection required for airline employees, H.R. 12611 was essentially an acknowledgement of the practice which had been developed by the Civil Aeronautics Board in 1950 and consistently imposed since that time—i.e., assuring that the benefits gained by the public would not be at the sole expense of employees.

In the report which accompanied the Senate's proposal for the Airline Deregulation Act, this Committee recognized that:

. . . Congress, on behalf of the American people, must insure that the benefits to the public which result from its decision to alter substantially the regulation of air transportation are not paid for by a minority—the airline employees and their families who have relied on the present system . . .

Congress, [in the past] having acted to prevent the normal free market evolution of the industry, now has a duty to the industry and its employees which would not exist if such action had not been taken." (Emphasis supplied).

S. Rpt. No. 95–631, 95th Cong., 2d Sess. at 114 (1978).

Contrary to that recognition, however, the Senate fashioned an employee protection program in S. 2493 which not only reduced substantially the level of benefits which airline employees had been accorded under both the House bill and CAB practice but also contained unique triggering mechanisms and agency action requirements which virtually insured the none-use of the diminished protection provided. Under the Senate's proposal, an employee would receive no protection whatever until 15 percent of the carrier's employees were deprived of employment within a 12 month period, and then, the protective benefits could extend for only a three year period. An employee would not be eligible for benefits at all unless he had been employed by his employer for four years as of the date of enactment of the Act. If it were determined that the employee was covered by the Act, the Secretary of Labor was given the authority to establish the monthly benefit payments and "reasonable" moving expenses.

As enacted, the Airline Deregulation Act contained the Senate "protection" program. The only compromise reached with the House (a reduction in the trigger mechanism from 15% to 7½%) made no significant difference. As enacted into law

the Deregulation Act provides the following insurmountable obstacles for employees adversely affected by the deregulation of the airline industry:

(1) 7½ percent of all employees of a particular air carrier must be deprived of employment because of deregulation in a 12-month period or an air carrier must go bankrupt before protection becomes effective;

(2) The CAB has to determine when 7½ percent is reached and whether deregulation was *the* major cause of the 7½ percent decline or the bankruptcy;

(3) The Department of Labor has to issue detailed regulations establishing a formula of protection implementing the general provisions of the Act.

The enactment of the Deregulation Act with its employee protection programs had one result which we did not fully foresee—the CAB took that legislation as a signal that Congress had mandated that the Board "disengage" itself from virtually all areas of "interference" with management decisions of airline executives, including those involving labor-management relations. Requiring carriers to aid their employees who were affected by mergers, consolidations or route transfers, was one example of such interference which, the Board believed, should no longer be countenanced in the post-deregulation environment. This approach to employee protection, however, was clearly unwarranted, for as Congress explained last year when it was considering the provison in the War Risk Insurance bill (Pub. L. No. 97-309) which dealt with the sunsetting of the CAB's jurisdiction over airline mergers and consolidations, the Deregulation Act had not been intended to change the manner in which the Board, prior to deregulation, had protected the interests of airline employees who were affected by Board regulatory actions. Indeed, the conferees to the War Risk Insurance legislation specifically requested the Board "to continue to impose standard labor protective provisions in a manner consistent with CAB's handling of [merger and consolidation] . . . transactions prior to enactment of the Airline Deregulation Act of 1978." H. Rpt. No. 97-864, 97th Cong. 2d Sess. at 4 (1982).

That request was urgently needed for within months after passage of the Deregulation Act in 1978, the Board's staff took the position that the Deregulation Act had eliminated the public interest justifications for imposing employee protective provisions in Board cases which would have a serious impact on employees. According to the Board's staff, the prevention of labor strife was the main justification for the Board's intervention and protection of employees in merger and acquisition cases. But, the staff continued, deregulation made that concern irrelevant, for a "strike on even a major carrier would not, as in the past, create serious disruption on routes served by the struck carrier since other carriers would be free to replace service lost as a result of the strike." *Texas International/Pan Am-National National Merger Case,* Order 79-12-163/164/165 at 65. In other words, one carrier's labor strike was another carrier's gain, and thus, the Board need not be concerned about the cause of that labor strife—i.e., the unjust treatment of employees affected by the Board's regulatory action.

That staff position was accepted by the Board in its first decision on this issue after the passage of the Deregulation Act. As the Board stated in that decision—the *Texas International/Pan Am-National Merger Case, supra,* slip op. at 67 (footnote omitted)—in view of Congress' directive that the Board deregulate the airline industry, "we think that gradual disengagement by the Board in areas such as labor-management relations, which the Congress did not specifically address, is proper." But since that newly-announced policy was a complete reversal of a policy which the Board had "followed consistently for nearly thirty years" (*ID.* at 66), the Board concluded in that case that: "A sudden change in the Board's labor policy would be unfair to those who had every reason to expect labor protection." *Id.* at 67. However, the Board then added that:

> We caution . . . , and put all labor parties on notice, that labor protection in the future will be provided only if and when the Board determines that it is required by special circumstances. LPPs will no longer be imposed as a matter of course, or because tradition dictates their use. We therefore advise labor to negotiate its own merger protections through the collective bargaining process at the first opportunity.

Id. at 67 (footnote omitted).

In every merger or major acquisition case which came before the Board after the *Pan Am-National* decision but before the demise of Braniff, the carriers, either initially or prior to a decision by the Board, requested the board to impose employee protective provisions. Airlines took that position because, as they explained to the Board in the *Texas International—Continental Acquisition Case,* employee protective provisions materially aided the consolidating carriers in integrating their operations and forces. Nevertheless, the Board still persisted in believing that it is contrary to the spirit of deregulation in the airline industry for that agency to require

merging or acquiring carriers to treat airline employees fairly. As the Board recently explained in refusing to impose even a hiring priority provision in the *Braniff-South American Route Transfer Case:*

In unregulated sectors of our economy, employees displaced by business failures are not entitled to preferential treatment from surviving firms in the industry. We do not view our regulatory mandate under the Act, or our pre-ADA decisions on LPPs, as directing any different policy for employees in the airline industry.

Slip op. at 26 (decided April 20, 1983).

Airlines have now read the unmistakable signals being given by the Board, and have now taken the position that Board imposed employee protection is too costly and is contrary to the spirit of deregulation. We have also read the unmistakable signs, and we are actively pursuing through the collective bargaining process the goal of obtaining job security provisions for airline employees.

Collective bargaining, however, does not hold out a complete solution to this problem for several reasons. First, in view of the Supreme Court's construction of our national labor policy on successorships, absent congressional direction, a successor company is not necessarily bound by its predecessor's agreements. Consequently, even if we succeed in requiring airlines to provide employee protection in merger, acquisition, or consolidation cases, it is not certain that the successor airline will honor those commitments. Indeed, in the *Braniff-South American* case, Braniff had previously agreed to support the imposition of employee protective provisions in route transfer situations, but Braniff ignored that commitment when it sold its routes to Eastern and the Board nevertheless approved Braniff's route transfer agreement. And second, because of the lack of uniformity in craft representatives in the airline industry, successful collective bargaining on the issue of employee protection would produce a plethora of agreements, which will most likely be inconsistent with each other. This will only complicate an already explosive situation.

Collective bargaining, however, is the "solution" adopted by the CAB, and the labor organizations are now actively pursuing it. As the IAM recently informed the Board in the *Braniff-South American Route Transfer Case,* job security is "a Number 1 strike item" in upcoming negotiations. Carriers will undoubtedly resist national job security agreements, and thus, it is logical to assume that this issue will gradually lead to bargaining impasses. Since the only rational solution, besides legislation, is a national agreement between all carriers and all labor organizations, those impasses will eventually disrupt the entire airline industry.

Contrary to the Board's belief, Congress surely did not intend to leave the equitable treatment of employees in a deregulated airline industry solely to the collective bargaining process. Congress, we submit, recognized in that Act that collective bargaining, while extremely important, is not a panacea for all ills. And thus, it included Section 43 in the Deregulation Act to aid employees affected by the change in regulatory environment brought about by that Act. Unfortunately, Section 43's program was not self-executing, but rather, as explained above, was dependent on several preconditions—i.e., the DOL's promulgation of regulations and the CAB's finding of a qualifying dislocation. As subsequent events have shown, and as we predicted would happen, those preconditions have made Section 43's benefits at best a cruel hoax upon the employees of the air transport industry.

At least two passenger air carriers have become insolvent and the employees on many carriers have suffered more than a 7½ percent decline in employment, yet neither the DOL nor CAB have acted. From recent indications however, when they do act it will merely have been to set in place final guarantees that no employee will ever be protected from the impact upon him of deregulation by any provision of Section 43.

Even if the CAB and the DOL had acted immediately, years of protracted litigation would have followed before anyone could have been protected. It is now almost five years after the enactment of the Deregulation Act, and the CAB just two months ago issued an order initiating its hearings on this matter. As might be expected, the Department of Transportation has taken the position that deregulation was not the major cause of any of the thousands of layoffs which have occurred since 1978.

A digression at this time is appropriate to explain what the CAB has recently done to ensure that deregulation will never be found to have caused adverse effects to airline employees.

Section 43 of the Act specifies that for an employee to be entitled to protective benefits, his employer must have undergone a "qualifying dislocation," the major cause of which was the change in regulatory structure authorized by the Act. While the Act says that a 7½ percent reduction in employment triggers the CAB analysis, the Board has created a procedure which will not result in a finding of a qualifying

dislocation unless there is approximately an 18 percent reduction. CAB has interpreted its statutory duty to mean that only when the sole or overriding cause of the major contraction was the Act will it find in favor of a "qualifying dislocation." In its recent order, the CAB has instructed the administrative law judges who will conduct the hearings to quantify the causes which contributed to the loss of employment and that no qualifying dislocation should be found unless at least 40 percent of the major contraction can be attributed to the Act.

The employees' problem is compounded by the fact that the burden of proof in the solution of this obviously insoluble arithmetic exercise has now been placed by the CAB squarely upon the employees.

To document their case, the employees must produce factual evidence on the percentage contributions of various causes of employment contractions. For example, the CAB has directed the parties to explore not only changes in route and traffic patterns since deregulation but also the changes in industry productivity since 1978. Additionally, evidence must be adduced relating to factors such as the recession, fuel price increases, the PATCO strike and lockout, the DC-10 groundings, mergers, major route expansion efforts, and other management initiatives. In a decision which guarantees the inability of the employees to make a case, the CAB has tentatively, but for all practical purposes finally, concluded that management decisions made under the deregulated economic climate are not factors to be linked with the determination of a qualifying dislocation. In order to fully comprehend the insurmountable odds placed against the employees, we believe that you must read the Board's order; therefore, we have attached to this testimony as Attachment 6 a copy of the CAB April 1983 decision. A reading of the Board's decision will compel the conclusion that employees have been cast as an adversary to the system and have already been declared the losers of a battle which has not yet been waged.

In a frightening display of bureaucratic machinations, the DOL regulations took a form that would effectively prevent affected employees from receiving the benefits to which they are entitled even if the 7½ percent trigger and the CAB anti-employee efforts did not exist. The DOL, for unknown reasons, assigned the task of executing its responsibilities under this "employee protection" provision of law to its Unemployment Insurance Unit rather than its Employee Protection Unit. Naturally resulting from that action was a program which resembled an unemployment insurance program rather than an employee protection plan. At best, an impacted employee could receive only 44.8 percent of his income and hundreds of thousands of dollars were to be wasted on the establishment of Deregulation Act units in each of the 50 states' employment agencies with each state agency authorized to interpret and apply this federal law as it saw fit. While this odd "protection" formula was created by the Carter Administration in its last days, we have no indication that the Reagan Administration plans anything different for the employees when, and if, it ever submits its regulations to the Congress. The first-right-of-hire program regulations proposed by the Reagan Administration, while an indication of some action, offer little solace to affected employees because of the limited role the DOL perceives it will play in ensuring that carriers comply with the program.

Labor foresaw these problems when the Deregulation Act was being considered by the Congress and so testified before this and other committees. Since the passage of the Act, Labor has appeared before the Congress to seek amendments to the law which would achieve just and equitable results for the employees. In 1981, when the House was considering H.R. 5103, the Civil Aeronautics Board Sunset Act, labor proposed various changes to the Deregulation Act's Section 43 in order to provide those benefits for adversely affected employees which Congress recognized were needed and which it had promised but which were not provided. The following enumerates the features of those suggested amendments:

(1) The four year eligibility requirement would have run from the date of enactment of the Sunset bill, rather than the Deregulation Act;

(2) Rather than being subject both to implementing regulations and to the necessity of subsequent appropriations, the amendments would have made the payments involved an entitlement program;

(3) The amendment shifted the burden of proof from the employees and placed it upon the carrier and the DOT;

(4) The 7½ percent trigger would have been removed;

(5) Time deadlines would have been imposed on both the DOT to determine the cause of the dislocation and on the DOL to determine the payment levels. If the time deadlines were missed, the claims would have been deemed granted;

(6) The DOL would have been prohibited from delegating its functions to any state agency;

(7) Priority in hiring requirements would have been extended to any air carrier holding a certificate on the date of enactment of the Sunset Act;

(8) Those employees who were both deprived of employment due to deregulation and deprived of the protections of the programs because of the unnecessary "triggers" would have been afforded protection;

(9) Standard *Allegheny-Mohawk* employee protective provisions would have been mandated for all future airline mergers; however, collective bargaining would have been permitted to supplant or supplement those protections; and

(10) Enforcement of the Deregulation Act program would have been accomplished through actions of the Attorney General, the DOL, the collective bargaining representatives, or the individual employees.

Labor was unsuccessful in its attempts to obtain any of the protections needed by the tens of thousands of airline employees who, by 1981, already had been injured by deregulation. Not only did Congress refuse to correct the protection hoax created by the Act, but it also neglected to protect employees from being stripped of traditional protective conditions by the CAB Sunset legislation.

In 1982, Congress considered measures to cure the defects in the Deregulation Act. H.R. 6077 and S. 2666, the Air Carrier Employees Protection Act, were introduced to remove the obstacles to protection contained in Section 43 of the Deregulation Act. The amendments in those bills substantively were the same changes proposed by Labor during congressional action on the CAB Sunset legislation in 1981. The need for those amendments was all the more critical in 1982 because of the unconscionable delay in the implementation of the Section 43 program by both the CAB and the DOL. By 1983, although the need for assistance is all the more pressing, Labor wonders if Section 43 was designed only to placate the employees. Whatever the intention was, however, deregulation has resulted in nothing but nightmares for affected employees.

Labor has not appeared here to fill the role of a prophet of doom for the employees have never wished deregulation to fail. The employee's welfare is obviously tied to the welfare of his employer. The employees of this industry have waited patiently and continue to wait for this Congress to fulfill its promise, indeed its commitment, to protect them against the ravages of deregulation. Section 43 with its gimmicks and mirrors has not done it and will never do it; well meaning words in Conference Reports about what the CAB ought to do will never do it; only a direct mandate of the Congress in the form of a specific law will provide these employees with the protection Congress promised and indeed has provided employees in other modes of transportation.

The employees of this industry have lived daily along with their employers with the agonies of deregulation and relying simply on their experiences of the past five years wonder what it will take for Congress to acknowledge that deregulation, while well-intentioned, was and remains a mistake. How much more unemployment, how many more bankruptcies, how many more cities are to be abandoned, before Congress rectifies the errors created through this total deregulation of the air transport industry. Labor recognizes the need for and advocates the regulation of route and price competition to eliminate the above-described problems. Apparently, the FAA also recognizes that regulation is necessary to prevent any greater decline of the industry. Labor now asks Congress to recognize that the deregulation experience demonstrates that airlines cannot prosper, let alone survive, in this atmosphere. On behalf of the thousands of employees who find themselves with no airline jobs and no protection, Labor urges this Committee to act now to protect the employees, the industry and the public from the harm and chaos caused by the Deregulation Act.

Questions of Senator Hollings and the Answers Thereto

Question. Mr. Mahoney, you stated in your testimony that labor believes that the full effect of deregulation has not yet been felt. If that is the case, when can we expect deregulation to have run its full course?

Answer. In recent years a classic irony has developed in American Government: All of the regulatory safeguards which bitter experience had demonstrated were required for the protection of the consumer should be abolished in the name of helping the consumer. This philosophic concept of deregulation in the name of consumerism began in the early and mid-seventies and took hold first in the air transport industry with the enactment of the Airline Deregulation Act of 1978. It then spread to the railroad industry, the trucking industry, and the motor bus industry. There are now indications that it may expand into the broadcast industry and beyond. It is not unreasonable to conceive of the deregulation of the insurance industry, the in-

vestment industry, and the banking industry. History tells us that once a concept of this type takes hold, it cannot be erased or even modified substantially until it has proved itself to be so harmful to the public interest that legislatures are compelled to take action to correct abuses. The insurance companies and the railroads in the 19th Century became so abusive as to compel regulation of their activities to protect the public—the consumers.

We respectfully submit that those who conceive of deregulation as a panacea for economic ills and consumer abuse simply do not understand or appreciate human nature. Human nature does not change. Ambitious human beings are basically unchanged from what they were 100 years ago and provided the unfettered use of economic power will destroy each other in their predatory competitive wars. But they are the generals and as in every war, it is the soldier who will bear the brunt of the battle. In these economic wars, the soldiers are the employees and the consumers and they ultimately will be the ones to suffer the most.

In our view, deregulation will have run its course when the effects upon the employees and the consuming public because of unstable air transport companies, extremely poor debt ratings of airline companies, undependable and low quality service, continually worsening safety records, enormous price disparities on different routes and a myriad of other effects necessitate a total or partial reregulation. The non-regulation of the 19th and early 20th Centuries ran its course when circumstances forced the enactment of regulations: Deregulation will run its course in the same manner.

Question. With respect to your discussion on wage reductions, can you tell the Committee what other avenues an airline faced with low-cost competitors has in terms of meeting those reduced costs?

Answer. An airline which is forced to the economic wall by low-cost competitors has very few viable options. It can reduce its payroll by give-back contracts or by reducing its work force; it can cut the quality of its service by eliminating meals, entertainment, etc.; and, it can cut the amount of its equipment thereby using less equipment but working it harder. It cannot cut its fixed costs which are enormous. Finally, the airlines can take that step which all other companies take as a first step in cutting costs when financial crises occur, they can cut their maintenance costs. This is done at first in small ways—less training, fewer people trained, new procedures invoked which are less time consuming, etc. When the demands for economies continue to press, inspections are made by other than licensed personnel (a practice American Airlines, Inc. has instituted with FAA's blessing) or such inspections can be made less frequently. Seemingly minor maintenance problems can be passed over until the "next time". None of these activities would take place overnight. They will take place only over a long period of time as a result of survival pressures placed upon airlines by their competitors. We do not now say nor did we claim at the hearing that the six aircraft fires in the month of June and the two forced landings due to lack of fuel which occurred during the month of June were "caused" by deregulation. Our only point was that in our memory such events had never before occurred in so short a time in the history of commercial aviation. It is at least worthy of Congressional attention as to why they happened to occur now. Were they the result of economies forced upon their carriers by deregulation or were they just a tragic string of coincidences which had never occurred before?

Question. What efforts should the Committee take to ensure a strengthening of the Federal Aviation Administration's mandate for airline safety? This is particularly important given your accusations that airline safety has suffered under deregulation.

Answer. We do not take the position that airline safety has yet suffered to the point of serious concern. We do take the position that airline safety is most definitely heading in a hazardous direction as a result of deregulation. In our opinion, the Committee should take whatever legislative action is necessary to ensure an adequate number of independent federal inspectors who will constantly maintain spot checks of commerical aircraft in order to see to it that air carriers do not give in to the temptation to cut safety corners.

Senator KASSEBAUM. Thank you.
Mr. Lindner.

STATEMENT OF WILLIAM G. LINDNER, INTERNATIONAL PRESIDENT, TRANSPORT WORKERS UNION OF AMERICA

Mr. LINDNER. Thank you, Madam Chairman and members of the committee. I am William G. Lindner, president of the Transport

Workers Union of America representing approximatey 40,000 employees of the aviation industry including mechanics, flight attendants and other ground personnel. I am most grateful to the subcommittee for the opportunity to address you concerning the impact of airline deregulation on the air system.

It seems to me that regardless of how the apologists dress it up we all know that under deregulation service has deteriorated whether you talk about spacing between seats, quality of food on board, frequency of flights, availability of schedule and price information or the cities you can no longer reach, the cities you no longer can reach get into and get out of in the same day. The frequent flier knows that service has steadily deteriorated in terms of comfort and convenience all as a result of deregulation.

The very name airline, the name of the game has become a misnomer unless you live in a hub city. You can no longer travel on a direct line to your destination. You must detour through one or more hubs with or without change of planes.

If the consumer or his planned destination is located in a nonhub community, chances are he will now be relegated to riding on a small propeller driven commuter-type airplane on part of most trips, an experience many jet passengers look upon with discomfort and apprehension. I notice that in the earlier discussion the question was raised about why the radical drop in traffic on these very short hauls and thin routes.

I can tell you as a person who spends a lot of time in flying I don't mind riding the small airplanes. I enjoy it as a sport, but I have a lot of friends who shudder at the thought of getting into anything with less than three engines and particularly if it isn't a jet. I know that the general public shares this apprehension about any airplane that isn't stable and steady and smooth. Of course, when you get into a smaller airplane you have to sacrifice those comforts.

Not only have thousands of career airline employees been displaced from their jobs without the protections promised by Congress, but unlike job losses in the past, radical route and city abandonments and restructuring has resulted in a layoff of hundreds of top senior employees forcing a stressful relocation or early retirement at a time that they reasonably expect the security they have earned.

A vice president of operations, I believe it was Western Airlines, in 1978 testified before either this committee or one very like it concerning the advisability of deregulation, and he predicted that his airline would have to reduce the annual budget for safety training by several million dollars to meet the cut throat deregulated competition he anticipated. This forecast has, of course, come into play.

The result of competition has produced a loss of steady revenue or predictable revenue to a point that economies have to be exacted and the most painless way of exacting those economies, of course, is reduced training and next to reduce maintenance.

Route abandonments by major carriers have left thousands of communities with replacement service by carriers operating smaller piston or turbo prop powered aircraft which many passengers

are uncomfortable with, or fearful of, resulting in economic disadvantages to those communities.

The industry as a whole has produced record financial losses since deregulation and in our opinion will continue to produce less than adequate returns as carriers fight to survive in the flood of excess competition resulting in repeated fare wars and route wars. Ironically, even the hundreds of millions of dollars taken from employees' paychecks through negotiated concessions to assure the survival of many carriers has too often been wasted in these endless fare wars.

Although former CAB Chairman, Marvin Cohen, evidently the high priest of the deregulation theology has given repeated assurances that the free marketplace will resolve all of these problems to our mutual satisfaction, evidently he believes that below-cost pricing will and should continue. He is quoted as saying that, and I believe this is a week ago before a committee hearing, and I quote:

> That below cost pricing could represent sound business practices in cases when operating a flight can make even a marginal contribution to a carrier's fixed overhead cost as opposed to letting the aircraft stay on the ground.

This, of course, is the reasoning that produces route and fare wars and why we can expect the wars to continue until many more airlines become casualties unless Congress acts to stabilize the industry. One would think that these aforementioned disasterous records since 1978 would be sufficient to cause Congress to amend the act, but perhaps the most damaging result of deregulation is taking its toll without widespread public notice, and that is the deterioration of safety standards and practices.

For example I would like to quote several documents. In the May 28, 1980 accident report involving Comair Airlines the National Transportation Safety Board cites as contributing factors in Comair's commuter crash "the pilot's inexperience in multiengined aircraft, a hurried departure, inadequate training, inexperienced company management, ineffective FAA certification and surveillance." This is the kind of replacement service that people in the smaller cities are expected to accept.

Another quote I think on point is the Aviation Daily carried a quote on March 2, 1983, of James Danneher, Director of the National Transportation Safety Bureau of Technology before Senate Transportation Appropriation Subcommittee on the 1984 budget, and I quote:

> Financially strapped commuters have a tendency to overlook and short circuit Federal safety provisions because of insufficient operating capital, and that in reality air carrier accidents can be correlated to the airline's profitability. For these carriers experiencing financial difficulty, safety provisions are the most vulnerable to cutting corners.

In the December 1982 Frequent Flyer magazine there is a quote of Mr. C. O. Miller, president of Systems Safety Inc. of McLean, Va., a former Director of the NTSB Bureau of Aviation Safety. He is referring to the tragic Washington crash and the methods used in investigating them, and he states:

> Your oversimplification is illustrated by the comments on the Air Florida crash. At the time the Airline Deregulation Act passed, safety ramifications of new and highly competitive groups coming into the airline business was of concern to many people.

Now, consider the facts of flight 90, a crew error, but how did it get there? Was it pressure generated externally from the company because of severe economic problems? Was it pressure from the captain to keep them flying? Was it ineffective training on the levels of engine thrust?

Were corners cut by the company or FAA in getting information about the 737's performance and icing conditions to the pilots? How about the fouled up coordination between Air Florida, American Airlines in handling the deicing procedures? Could these factors possibly have resulted from the effects of deregulation? Who knows.

NTSB never really investigated the crash from that standpoint. Given deregulation as a cornerstone of the current administration, could the steering away from the deregulation issue in the Air Florida case be a sign of politicizing of NTSB output? Or was it merely an oversight?

I do not know the answers to these questions. I can say that in my close association with the Board going back well over a decade I never had reason to raise the question of political influence directly on a report until now. In a speech I delivered prior to the Air Florida crash I predicted that one of two things would have to take place before NTSB got back to some semblance of leadership in aviation investigation.

Either an indepth study of the Board would have to be conducted by Congress, or "a catastrophic accident would have to happen, preferably near Washington." I guess I should have added with a Congressman onboard. That last reference, of course, is to the history of the Civil Aviation Act going back to 1938 and the tragic Cutting—Senator Bayavel Cutting, of New York—air crash which is now a matter of significant history.

I have one other document I will skip reading but in essence it refers to a recent announcement by American Airlines, one of the better airlines in the industry I might say, announcing that they will no longer have licensed mechanics inspect aircraft at maintenance bases throughout the system which has been a practice since the original Civil Aeronautics Act was established.

They are now going to have the aircraft handled by people who normally handle cargo. These are the people who will move the airplane on and off the gate, but the mechanics who normally did that work and also inspected the airplane, looked at the logbook, walked around the airplane and looked over the tires, the fluid levels, and looked for damages or signs of failure will no longer be on the scene unless called.

Now the carrier will exact two economies in that practice. One is, of course, they will no longer have to have as many mechanics on the payroll and on the location and probably more importantly since the mechanics will not be looking at the aircraft things that might have stopped the operation for repairs are going to be ignored and the flight will continue.

It gets suspiciously reminiscent of the old saying we had on some of the smaller airlines years ago: "If it flew in it will fly out, and keep your fingers crossed." This is what is happening as a result of the pressures of below level or less than necessary levels of revenue.

With the continuing battle for routes and the continuing fare wars, I see no end to the pressures on the corporations to reduce costs. Therefore, we can anticipate that they are going to eat into their infrastructure. They are going to eat into the reservoir of knowledge, skill, and dedication that they have had to the point that we finally reach major failures.

An interesting corollary the other day and I don't know if you've noticed in the papers down here in Washington, but in New York City the subway system has suffered over 10 derailments in a period of a month, something that is outlandish. The president of the transit authority in New York made the announcement that this very serious and hazardous safety condition should be blamed on the people who managed the system 10 years ago.

There, of course, is a little buck passing in that, but there is also a grain of truth and what we are doing today is going to come back to haunt us in the next few years if something isn't done to change the picture. I would say in closing that unless the Congress finds in their wisdom a means of curbing the fare wars, and I think along with it you have to look at route entry as well, we are going to see a steady deterioration of what was once the most efficient consumer oriented transportation system in the world and as one individual who has served and worked with that industry for better than 30 years, I am sorry to see the state that it is in today.

QUESTIONS OF SENATOR HOLLINGS AND THE ANSWERS THERETO

Question. In your testimony, it was stated that labor believes that the full effect of deregulation has not yet been felt. If that is the case, when can we expect deregulation to have run its full course?

Answer. The full effect of airline deregulation will be felt after several years of relative prosperity, during which the strong hub operators will destroy or take over weaker competitors. At that time, we can expect infusion of cheaper equipment requiring less personnel to operate and maintain into the industry. The end result will be that the industry will be less competitive and more difficult to enter than when the whole regulatory process started.

Question. With respect to your discussion on wage reductions, can you tell the Committee what other avenues an airline faced with low-cost competitors has in terms of meeting those reduced costs?

Answer. Carriers attempting to deal with low cost competitors can do, basically, the following:

a. Abandon profitless cities and all routes to competition or subsidize essential service carriers;

b. Reduce expenditures for preventative maintenance to match competition;

c. Reduce expenditures for training and safety programs to match competition;

d. Reduce seat spacing and increase seating capacity;

e. Reduce the quality and quantity of meal service;

f. Reduce pilot, cabin, and maintenance crew complements to match competition;

g. Seek more international route authorization to foreign countries which are fully regulated.

Most carriers are already exercising all of these options.

Question. What efforts should the Committee take to ensure a strengthening of the Federal Aviation Administration's mandate for airline safety? This is particularly important given your accusations that airline safety has suffered under deregulation.

Answer. In my opinion, the FAA has a nearly impossible problem. Given the continuing weak revenues suffered by the industry since deregulation, it is foolish to place much confidence in self-policing by the carriers as in the past. The simple fact is that the maintenance and operating safety standards achieved in the past can only be maintained under deregulation by a manifold increase in surveillance by the FAA air carrier inspectors.

Unfortunately, since deregulation precisely the opposite has occured. The FAA has reportedly depleted the ranks of general aviation inspectors to meet the increas-

ing burden the air carrier inspection force is experiencing. In view of recent weakening of safety enforcement efforts by OSHA and EPA, it will be an uphill battle to provide the massive funding, workforce expansion, and dedication needed to force high standards on weak carriers. Any objective examination of the agency's performance over the past four years would show that the FAA, despite having one of the largest budgets among the federal agencies, was totally unprepared to cope with the myriad of new carriers and changed operations fostered by deregulation. The FAA's incapacity to properly police the industry in the face of deregulation was undoubtedly the reason for the Regulation by Objective fiasco. RBO was, or course, a program designed to allow the FAA to jettison its responsibilities to police air carrier safety.

Under such circumstances, one of the few things Congress can do short of full scale reregulation of the industry is to make sure that no carrier is allowed to operate without a full complement of certificated airmen and women peforming basic functions like maintenance, inspection, and aircraft monitoring. With the depletion of general aviation inspectors and the apparent inability of the FAA to police carriers, the last bulark against corner cutting is the certificated employees in the industry who, due to their licenses, owe a measure of responsibility to the public as well as their employer.

Notably, carriers have been attempting with increasing frequency to use non-certificated personnel to perform inspection and monitoring duties. This practice, which I alluded to in my testimony before the Committee, originated with many of the new entrants (who would not secure and pay full complements of licensed airmen), but is now apparently spreading throughout the entire industry. RBO would have accelerated the use of this unfortunate practice and brought about the eventual demise of certification requirements for persons performing many important functions pertaining to air safety. If Congress hopes to maintain any semblance of the high safety standards which have traditionally characterized the industry, it must act to halt the erosion of certification requirements and the practice of allowing aircraft inspection, maintenance, and monitoring to be performed by untrained and unlicensed personnel.

Senator KASSEBAUM. Thank you very much. There may be flaws to address in the system, and that is what we are trying to get at in these hearings, but I am a bit troubled about the belief both Mr. Mahoney, yours, and Mr. Lindner's that maintenance is a factor in deregulation and that this has suffered.

I wonder if you have specific reasons for believing that the fires that have occurred can be tied to deregulation. I just have a hard time correlating that.

Mr. MAHONEY. No; I have no specific information on that or facts on that, and those are being investigated, of course, by the NTSB and they will come out with whatever conclusions they reach on it. I do know and my only point was that in my experience which goes back 30 years I do not recall any such incidents ever occurring so close together all involving generally the same type of problem, fire, and all occurring on major airlines.

Now this could be just coincidence and I suppose that's true, but I would say that it is sort of a strange coincidence.

Senator KASSEBAUM. Well, they were different types of fires.

Mr. MAHONEY. Oh, yes. They were engine fires and electrical fires.

Senator KASSEBAUM. I think it is a very misleading allegation, without some specific facts to tie into, even to raise that.

Mr. MAHONEY. My only point was that this is the only time, in my experience, that it has happened, that you can put this type of thing—they are all maintenance problems of some sort. Now whether they were a failure in equipment or whether it was a failure in the maintenance, the mechanics, the negligence on the airlines, who knows. I don't know and I don't make any accusation.

All I am saying is that they all happened and it makes one a bit squeamish about getting on airplanes because they never happened before.

Senator KASSEBAUM. It does not make me squeamish, and I have to say I ride prop planes in Kansas, too.

Mr. MAHONEY. You're a courageous lady.

Senator KASSEBAUM. No. I just think that in an area such as this we need to be very careful, obviously, in statements that are made because the public does get very nervous. Obviously, I think it has been your concern as it has been those of us here who work on aviation matters that the highest levels of safety are maintained.

I have been one who has been somewhat critical that NTSB recommendations are not followed through with some of the directness and accountability that I wish they would. I think this is an area that we need to pursue because frequently the NTSB has made recommendations that have not ever really been followed through on. But to say that this has all resulted from deregulation I think is going a step too far.

You mentioned, Mr. Lindner, the deicing procedures. Those have been a concern long before deregulation, and they still are. Actually what would be sound practice to follow and what recommendations the NTSB would make, some airlines do have deicing procedures. All have in one way or another various practices they follow. Is this something that should be a standard throughout the industry? But again I cannot myself tie it to deregulation.

Mr. LINDNER. I would like to respond to that briefly on the simple matter of the deicing. Certainly after a very technical study you can draw up what should be a specification for everybody to follow. What is overlooked, I think, through lack of familiarity with how an airline operates is that by and large most airlines do more than what the regulations require.

They have learned through experience with their own particular operation and their own particular equipment that you go one better than what the rule says because it is good business. It is safer and it is better for our business.

But when the squeeze is on and the competition is eating up your market and the importance of making schedule becomes overbearing, you have to start looking the other way at some of these problems and some of these questions and you have to be a little more inclined to cut corners if you're going to meet that competition because that is what they are doing.

Of course, in the case of the Air Florida crash they were out on that taxiway for a long, long time. They probably knew that and I would bet that back under regulation they wouldn't sit out there that long because missing a schedule would not be that vital to them. The competition would not be at their throats, and they could take a little more time and be a little more cautious.

This is the pressure that deregulation is putting on the operations not only from the financial standpoint which is gutting their reserves, but it is putting the operational pressure on when the question of who gets out of the box first—it's like a horserace—and who is most reliable and on-time performance becomes important, more important than it ever was. Therefore, the pressure builds and builds.

I would like to read into the record a very brief—this is a teletyped message issued by American Airlines just a week ago. It says, "Post on immediate attention boards for all cockpit crew members June 19 subject predeparture walk around inspections. Since predeparture walk arounds are no longer performed by maintenance personnel, flight engineers"—and I would call your attention to the fact that there is a growing fleet of aircraft that have no flight engineers anymore—"Flight engineers, flight officers, and first officers are reminded to be especially attentive to wheels, tire pressures, tires, breaks, fluid levels, bottle pressures, during crew walk around inspection. The items become even more critical with the onset of summer and the increased schedules. During these periods of high temperatures the captains will continue to insure the timeliness and integrity of these required walk around inspections."

Now everybody in the business knows that this is a lot of double talk because they are kidding themselves. In a big hub like Dallas, Tex. the crew members barely have time to get out of the airplane and get back in and they're underway. To do a thorough inspection is just impossible.

However, the FAA says this is acceptable, and this has got to reduce the level of safety. It is just a matter of a rational approach to handling the problem, and this is why they had mechanics there before, up until now.

Senator KASSEBAUM. You can take the other side of the coin, too, and say that with the competition it is ever more important that these airlines have the highest safety record because they are liable, and it cannot only destroy an airline when a tragedy occurs.

Mr. MAHONEY. Well, Madam Chairman, I think you are right in the sense that they do have to respond economically and to the competition, but where they—and our whole point, as Mr. Lindner mentioned—where they are being pressed financially, they will or there is a tendency to cut corners. And all we are saying is even if you want to assume that no corners have ever been cut even with this bulletin that American Airlines put out that Mr. Lindner just read, that that is not cutting a corner.

It seems incumbent upon the Congress because they must know, the Congress must know that these airlines are placed under tremendous economic pressures by all of this myriad of small airlines and the opening of all the routes, and where they have had huge investments, those investments can go right down the drain by a bunch of airlines who just rent an airplane and start running across the country at low rates. This is the way it started.

But the point is that the Congress should at least impose some sort of statutory, strict statutory regulation upon a law that would cause the FAA to be extremely careful and make sure that none of these things that are subject to economic pressure occur, at least in the area of safety. And that is really the point of this.

Senator KASSEBAUM. What would you do?

Mr. MAHONEY. By way of legislation?

Senator KASSEBAUM. Yes.

Mr. MAHONEY. Well, I think that would take some thought as to what one might do to enact something into law, but I think it cer-

tainly can be done. I have nothing specific in mind because I am not a safety expert.

Senator KASSEBAUM. Are you saying that we should go back to regulation as we had it before?

Mr. MAHONEY. I would say yes. I do not know if you could do it now because the panel that was up here earlier said that you would drive companies into bankruptcy if you did it now. Well, of course, you drove companies into bankruptcy when we had deregulation. Air New England went into bankruptcy almost immediately, and the president of Air New England said deregulation has killed us; this is why we are in bankruptcy.

Almost simultaneously with that statement by the president of Air New England, Mr. McKinnon—I believe he was chairman of the board then—said deregulation had nothing to do with it, although he did not know, I think, what the president of Air New England knew about his own company.

But nevertheless, I think it can be done and it should be done, and we must be extremely careful in this area. I would go back. Going back is very difficult. Philosophies are very hard to change, human nature being what it is, when you get a ball rolling. It is human nature. And also this happened with deregulation. That went through the Congress, and all of a sudden it caught on and everybody thought it was a good idea. Nobody thought it was a good idea at first except one or two people. Within 2 years everybody thought it was a good idea. There was no stopping it. Everything was deregulated. And getting it back, changing back again would be extremely difficult unless we had the same problems we had in the mid-1800's when we ended up with the ICC, problems we had in the early 1930's when we ended up with the CAB. And we will have them. I am quite sure we will have them. And we will have reregulation, but it will take a long time.

Mr. LINDNER. I would like to add to the points raised by Mr. Mahoney.

As far as the FAA's surveillance of the safety practice of the airlines, it is general knowledge that right now the FAA is so short of available air carrier inspectors for this purpose they are presently using 50 percent general aviation inspectors. These are people who normally inspect small aircraft operated by private people for private purposes and small charter operators. They are now using these types of inspectors on an emergency basis to try to fill the gap on air carriers because there are so many more carriers and so many more problems.

On a related point, and getting back to what we should do, I recognize that changing the industry after what has happened to it under deregulation for the last several years is going to be extremely difficult, if not impossible. But the two areas that need, I believe, immediate attention if the situation is to be saved is to put some sensibility into pricing, some control on how far predatory pricing can go, and as Mr. Cohen said last week, it makes good sense to try to gouge into the competitor's routes, even below cost, which is predatory pricing. It makes good business sense if you can make a couple of bucks over your overhead that you would otherwise lose.

This is what everybody is doing and will continue to do, and the only way it will stop is if the Government puts an effective regulation that says it no longer can happen.

Second, if you do not curb the practice of jumping on other people's routes whenever you have a slack period or some lack of equipment, the erosion of revenue that will stabilize the industry is just impossible. Without that stable revenue, safety is going to suffer, and it is just a matter of time. In the case of the subways it took them 10 years to really run them into the ground. In the airlines I think it will be a lot faster.

Mr. MAHONEY. Madam Chairman, Mr. Scheri would like to answer that.

Mr. SCHERI. Madam Chairman, as far as regulation versus the conditions that we are under right now, we would like to point out to you, you and your committee, that basically just within the Machinists' Union alone since the enactment of the Airline Deregulation Act of 1978—it is not even 5 years old yet—we have had five mergers that we have been involved in: Pan Am and National Airlines, North Central and Southern, Republic, Hughes Air West, Flying Tigers, Seaboard World, and the latest one that we are still trying to unsort, which is Continental-TXI.

I might further point out to you that Mr. Mahoney just pointed out Air New England, a straight admission by the president of the company, but yet we hear it being denied by the CAB that that carrier did not go belly up, chapter XI, as a result of dereg.

Well, we happened to represent their employees for many years, and we followed it right into the point of chapter XI, and there is no doubt in my mind that that was a result of dereg.

I would like to point out that we just had another, I will not even call it a commuter carrier—it was somewhat of a regional type airline—and it has been in business for several years, Altair Airlines, and they were running medium type equipment out of North Philadelphia airport, and they were leasing, I guess, just about the time they went belly up, DC-9 aircraft from Air Canada, and they had plans of expanding into the Florida market. In fact, they were talking about moving their maintenance base from Philadelphia into Jacksonville—big high hopes. And what happened as a result of dereg, in my opinion, they went chapter XI last year, and they are still under chapter XI proceedings.

The point I am trying to bring out to you is that I would like to see Congress for a change look at the little employees out there who have been affected as a result of this act. Our union alone has 14,000 licensed A&P mechanics on the street. And you want to talk about safety, which we were talking about earlier, no doubt in my mind because I am a licensed airframe and powerplant mechanic, and I did work under the respective pressures in the hangars and in the flight lines. And yes, in my opinion they are cutting corners to stay in business.

As you well know, the record is showing more and more bankruptcies within the industry, and yet to be seen, more mergers. And the people sitting at this table, I can take you back to 1977 when we all testified before Congress. We set the road map which we felt was going to happen if the Airline Deregulation Act was passed, but I guess many Members of Congress did not believe us,

and they passed it. And if you take our testimony that was presented by Mr. Mahoney back in 1977, because they always say the labor movement drugstore quarterbacks, Congress—well, we were not drugstore quarterbacking anybody. If you look at it, you will almost see it happening to a "T" about more mergers and the cutthroat competition and the safety problems, and more important, the employees that have been affected that have had to pick up their roots and relocate after many years of service to a dedicated carrier. And many of them do not even have a job in the industry any more. Their unemployment benefits have been exhausted, and here are skilled people out there that are not being utilized.

Yes, the records shows the CAB through figures that there has been a bunch of commuters started up. Well, if you check the record, Madam Chairman—and I believe you probably already have—you will find most of these new employees coming in at low pay scales, not fully skilled as the skills that we have out on layoff. I think it is really a blast to our respective people that we represent in this industry that have put their livelihood forward in this industry, and they have not been paid one plugged nickel under labor protective provisions as Congress enacted it on October 24, 1978.

I am quite sure if we were ever that relaxed as labor organizations with our members, our people would probably throw us out of office within our first term. But, however, Congress has not put in any additional pressures on the Department of Labor or the CAB, and now this thing is rolling, and for approximately 5 years when none of these employees receiving one plugged nickel in the form of labor protection provisions.

Thank you.

Senator KASSEBAUM. Thank you.

Let me just make a couple of comments.

One, when you said this sailed through, I think there were 26 markup sessions, so as you know, it was not an easy piece of legislation. I was not here, but I remember reading about it at the time, and it did not really sail through.

Second, I would like to say in talking about the mergers and the chapter XI's and so forth, I do not know that you can put that at the door of deregulation as much as mismanagement, and I think you have to count that in. It is the employees who have suffered, that is true. But I think it is a little easy to make deregulation the scapegoat when sometimes when you analyze the particular situations, certainly you can fault the way that the management has handled the particular operation.

I think that certainly one thing you have raised—and, Mr. Mahoney, you raised it in your opening comments, too—that obviously is something that we have not followed through on with the diligence that we should have, although we who have worked in trying to come up with an answer, and that is the labor protection provisions that were part of the act, it is something that we need to do. It is something that the CAB and the Department of Labor and the Department of Transportation have all sought to find an answer, and time is drawing short for doing that. And that will be part of, I hope, a proposal that can be made by the administration that we can work on in hearings in September, because that is or that was

part of the legislation, and it is something that has never been implemented and never been able to draw up the implementation of that provision to the satisfaction of all parties concerned.

Thank you very much for your testimony.

Mr. MAHONEY. Thank you very much, Madam Chairman.

Senator KASSEBAUM. Mr. Genoese.

STATEMENT OF WILLIAM GENOESE, SECRETARY-TREASURER OF LOCAL 732, AIRLINE AND AEROSPACE EMPLOYEES, INTERNATIONAL BROTHERHOOD OF TEAMSTERS, ACCOMPANIED BY WILMA LIEBMAN, COUNSEL

Mr. GENOESE. Thank you.

My name is William S. Genoese. I am here to represent the International Brotherhood of Teamsters. We have already submitted our papers to the committee.

I do have Ms. Wilma Liebman here as counsel for the Teamsters organization to my left.

I would like to start off saying, Madam Chairman, and members of the subcommittee, the International Brotherhood of Teamsters welcomes this opportunity to express its views on the impact of airline deregulation.

At the outset, we have to state that our general president, Jackie Presser, and our entire general executive board are extremely concerned about the impact of airline deregulation. We feel strongly that congressionally imposed labor protective provisions are needed to safeguard airline employees who are adversely affected by this legislation.

The Teamsters Union, with its 1.8 million members, is the largest union in the free world. Our airline division, representing approximately 30,000 members, is one of the largest unions in the air transportation industry. Additionally, we are the only labor organization to represent workers employed in all phases of air transportation and in all its bargaining crafts and classes.

The International Brotherhood of Teamsters adamantly opposed the Airline Deregulation Act of 1978. This opposition has been amply justified by succeeding events. Since the passage of deregulation in October 1978, airline carriers have posted record losses. One major carrier declared bankruptcy and terminated operations. Several other major carriers are hovering at the brink of chapter XI.

But the impact of deregulation is not reflected solely in these financial losses. The situation is made more serious by the human tragedy of thousands of airline employees out of work. They have borne the greatest burden and have been the chief victims of deregulation.

According to Civil Aeronautics Board estimates, at least 40,000 full-time jobs have been lost in the air transportation industry since December 1979. Approximately 10,000 people lost their jobs in the Braniff bankruptcy alone, over half of whom were represented by the International Brotherhood of Teamsters.

But even these unfortunate statistics do not fully reflect the total picture of the countless others who have preserved employment only by uprooting themselves and their families and relocating in

other cities, and others who have sacrificed hard-earned rights and benefits. These intangibles can never be measured.

We, like many others in the industry itself, seriously question the irrational and self-destructive behavior of this industry since deregulation. The suicidal fare wars taking place are directly linked to serious cash flow problems. For many carriers, cash flow has become such a serious problem that fare pricing bears little relation to actual cost.

David F. May, president and chief executive officer of Republic Airlines, recently addressed these problems, stating that with the irresponsible fares, priced below production costs, the airlines are "frittering away the concessions that the employee groups have given us, as well as what equity we had to start with."

In his view, the consumer is hurt by this behavior. He said, "The public probably is better served to have reasonable competition than to let the industry destroy itself to where there are only four or five major carriers left, all charging high prices."

In our view, the deregulation experiment has been, both in economic and human terms, a costly failure. Only some form of regulation of the industry to prevent irrational pricing will relieve the situation. But if the experiment is not to be ended, then we would hope that Congress would take steps to design an effective, practical program to protect airline workers, who make this vital industry run, from the injurious effects of the industry's apparent drive toward self-destruction.

The current legal structure is simply inadequate to protect employees from the exploitive labor policies of the deregulated environment. The employee protection program of the Airline Deregulation Act is, to date, a hollow remedy. Not one single airline employee has obtained any protection under the Airline Deregulation Act's labor protection provisions. Specfically, not a single airline employee has received the benefits of the preferential hiring provisions of the act. In fact, final regulations have not yet been adopted by the Department of Labor. Further, not a single employee has received the income maintenance protection promised by the act.

Five years after passage of the act, the CAB has just scheduled the first hearing on entitlement to labor protection, and it has erected so many obstacles to the realization of the benefit that it has effectively negated the congressional intent and precluded workers from recovering.

Additional legislative guidance is needed regarding entitlement to labor protection. We ask Congress to establish standards which are sufficient and realistic to allow employees to avail themselves of the remedies that are now due them solely in theory. Our specific proposal on this matter is contained in our written submission.

In addition, we urge Congress to enact the labor protective provisions now imposed by the CAB as a condition for approval of intercarrier transactions, such as mergers and acquisitions of control. These protective measures include most importantly for seniority list integration and for certain compensation for the adverse effects of the transaction.

Since the CAB will sunset on December 31, 1984, statutory enactment of these provisions is vital, especially in today's deregulation atmosphere which has apparently stimulated merger activities.

Mandatory seniority integration provisions in particular are vital; they would entail no cost to the Government and little to carriers.

Finally, we urge Congress to provide for the maintenance of existing collective bargaining relationships in merger situations. The recent experience of the Teamsters Union during the Texas International-Continental Airlines merger best illustrates the need for this kind of protection. That story is fully set forth in our written statement.

Suffice it to say that under the present legal structure, the post merger Continental Airlines was able arbitrarily to oust this organization as the representative of 1,000 former Texas International employees, abrogate their collective bargaining agreement, and affect changes in their terms and conditions of employment. Surely, airline employees, at a minimum, deserve protection from this form of exploitation.

I would like to say that my main purpose here today, we are living in a changing environment and changing times, and nothing really stays the same. When people do make changes, and they expect it to work out a certain way and they do not work out, we think that there should be some recourse from the Government, if we cannot get it from the carriers, of protecting people's jobs and protecting their lives, and also, too, where their future may be because they have a vested interest.

And up to today's date the U.S. Government has done nothing to live up to the promises of 1978. And we are practical type people, and we know that what was yesterday has to change today.

I would like to say that I appreciate having the opportunity of being here. Our general president, Jackie Presser, would have liked to have been here, and our secretary-treasurer, Ray Schisling. Unfortunately, they felt—they sent me over here. They said that I would be more qualified to answer your questions that you might have because we represent the rank and file.

Senator KASSEBAUM. Thank you very much, Mr. Genoese.

I would like to ask you if you have given any thought, given the recession—and this is something that really has not been brought up this morning in the hearings—and the impact of that recession on the airline industry. What, if it were still regulated, do you think the losses would have been due to recession in the industry?

Mr. GENOESE. Well, let me just say this, that all of the smart people around, they are always trying to find a reason why certain things do not take place or they do take place. They turn around and they said if you did not have fuel prices, which they did not expect to go up, you would have made millions and millions or billions of dollars. Then they turned around and said if the economy stays the same, you would have made millions and millions of dollars. Then they said if the Third World did not act up and we did not have the trouble with Iran and so forth, we would have made billions and billions of dollars.

Well, it did not happen, and what happens is this: The airline industry is so—it is a different type of industry, and being a different type of industry that they have to have skilled people in certain crafts and classes in order to maintain an effective airline system, not alone just for passengers but for any other purposes that it may be, is that they have to take into consideration that

invulnerable to changes, whatever it may be, without the whole world and let alone the United States or the economy.

So today's problems are only some of the problems. Tomorrow we do not know what the problems may be, and it might affect the economy again; but more importantly, that the workers should have some protection. And that was what they were sold on at the beginning, so regardless of what happens in the future, they need some type of protection.

Now, if things get good, nobody needs any protection, and therefore, they would not pay any money out.

Senator KASSEBAUM. Well, protection due to deregulation, if indeed it was a loss that was due to the deregulation of the industry. I mean everybody—you are talking to someone who sees farmers really suffering real losses, and there is no guarantee to them when they get the losses. But if indeed there were losses that could be shown were directly tied to the deregulation that ensued, then those deserve the protection there.

And that is why I am saying I think there were, it would seem to me, and I do not have the figures, there must have been a number of significant losses, however, for employees that just simply resulted from the fact that the public was not flying for a period of time during the recession.

Now, this is coming back up, and it is improving, and the economy is on the upswing. But I think there were a number of factors that did hit there. As you can say, we can always say these things, but they did happen, and they certainly must have had some impact that weighed in on losses that the airlines sustained that were not due just to deregulation.

Mr. GENOESE. Madam Chairman, just let me say this, that on behalf of the little person, the little one that goes to work every day, and they do not understand the deregulation, they do not understand the economy the way it should be, they want to bring home enough bread and butter in order to feed their family, and representing people 99 percent of my adult life.

When it was passed, deregulation was based on the premise that the economy was going to go up. And then they turned around and they said hey, if it goes down 7½ percent, we are willing to give you these particular things. But when unemployment went beyond 7½ percent and the companies went bankrupt, no one really knew that they were going to have this type of competition. Nobody knew that the communities were going to come in and eat their particular lunch. No one had, including the Government, including the unions, including the public, whatever it may be, and what happens if it was not built on good times.

I said I went to a special meeting at Harvard when they had all the brains in the world. They had the bankers there. They had the airline people. They had the learned CAB Chairman, former Chairman, and various other people. And they were trying to carve up a turkey, but not once does anybody turn around and say what about that little guy or that little woman or that person doing a particular job. And they said this is a free enterprise system. If they do not have a job here, go someplace else.

The point we are trying to bring down to you right now is there has got to be some written invitation, maybe not as rigid as maybe

other people say, but some written protection in case it slides and slides and slides or they turn around and say people just lose their particular job.

I happen to represent people in various stations like Mobile, Ala., or San Diego or places like Baltimore where they turned around and said no longer can you live there, that in order to maintain your job you have to go somplace else in order to maintain that. And they have to pull their kids out of school. They have got to turn around and say that their relatives or the wife was working and got a job and they just can't handle the situation.

We say we really feel very strongly that the Government did not look at it in all the facets they could have to protect the worker. My job is to protect workers.

Now, who got us in to this mess? It was management. Management really did a bad job. First of all, starting off with Braniff, and what happened, there was no recourse for the workers to turn around and say hold on, you are doing something wrong.

Now, with Pan American-World Airways, we sat down, and when we saw the merger of National and American, the Teamsters Union was the first to come in and say what they needed was a 10 percent cut and a freeze and set up an ESOP program so we have the input.

We continually say we want these companies to survive. We are not here to put them out of business. But in return, where does that person stand with some seniority? We are not talking to people who were hired after 1978 because they have no right whatsoever.

The point comes down to one thing: That we feel very strongly, very strong that no one took that little person into consideration. I feel as a person here today that I and our organization did not do enough on behalf of the people. Steven Bryant turned around and said I think labor was misjudged or misjudged the legislators. He was the architect of the Airline Deregulation Act, and he as a judge up in Boston said that what happens with this, you believe the wrong people that did not react the way you should have in order to protect them the way you do.

Now, to put the egg back together again is a very difficult thing. Something must come up that I am saying to protect the workers.

Senator KASSEBAUM. You mentioned ESOP during the course of those comments. Are you supportive of that type of program?

Mr. GENOESE. You want to know the reasons why? In Pan American we gave up like $200 million, and in return we got 35 million shares of stock which is something equivalent to like 6 to 1. Today it is worth like—it went up three times as much, thank god, for the workers making a concession. If they would not make a concession, they would not be around.

ESOP was put together so the workers could make some input for the mistakes which were being made by management at the top level, because it is in a trust fund and the workers do not touch that stock until they die or retire or whatever it may be at the present time. And we also got a member on the board of directors, and we are hoping to get more people on it because usually these top companies are interested only in one thing—to do what they

want to do—and do not take the workers into existence or take them into consideration.

Forget Pan American. Take Eastern Airlines where the unorganized people have nothing to say. The Continental group that we used to represent, Texas International, and Continental took them over. They have nothing to say in the classes and crafts that we have a lot of representation in today.

I would just say TWA, and American and United Airlines, nobody speaks for those people whatsoever except when some of the machinists are speaking for the machinists, and the pilots are speaking for the pilots, and the flight attendants for the flight attendants. But we are speaking for everybody, the organized and the unorganized—one of the few unions that do this thing—because we feel that there has got to be some protection, and being very vocal on it.

Senator KASSEBAUM. Thank you very much. We appreciate your being with us today.

Mr. GENOESE. Thank you.

[The statement follows:]

STATEMENT OF WILLIAM F. GENOESE, SECRETARY-TREASURER, AIRLINE AND AEROSPACE EMPLOYEES, LOCAL 732, AFFILIATED WITH THE INTERNATIONAL BROTHERHOOD OF TEAMSTERS, CHAUFFEURS, WAREHOUSEMEN & HELPERS OF AMERICA

Mr. Chairman and Members of the Subcommittee: The International Brotherhood of Teasters welcomes this opportunity to express its view on the impact of airline deregulation.

At the outset, we have to state that our new general president, Jackie Presser, and the rest of our Teamster general executive board are extremely concerned about airline deregulation's impact and strongly feel that congressionally imposed labor protective provisions are needed to safeguard airline employees who are adversely affected by this legislation.

The Teamsters Union, with its 1.8 million members, is the largest unions in the Free World. Our Airline Division, representing approximately 30,000 employees, is one of the largest unions in the air transportation industry. Teamster members are employed in all sectors of the industry: certified carriers (Scheduled and supplemental), air taxi and commuter carriers and intra-state carriers. We represent virtually every craft and class in the industry: pilots and other flight deck personnel, flight attendants, mechanics and related, stock room and stores employees, clerical, office, fleet and passenger service, dispatchers and communications. We are, in fact, the only labor organization to represent workers employed in all phases of air transportation and in all its bargaining crafts and classes.

The International Brotherhood of Teamster adamantly opposed the Air Line Deregulation Act of 1978 (ADA). This opposition, we believe, has been amply justified by suceeding events. Since the passage of deregulation in October 1978, airline carriers have posted record losses. One major carrier declared bankruptcy and terminated operations. Several other major carriers are hovering at the brink of Cahpter XI. In addition to these economic losses, there is the human tragedy of thousands of airline employees out of work, not to mention the countless others who have preserved employment only by uprooting themselves and their familes and relocating to other cities, and other who have sacrificed hard earned rights and benefits.

As Teamsters General President Presser has noted, "How do you accurately measure that incalculable economic toll, much less the hidden repercussions. And we aren't even talking about the others being affected—youngsters uprooted from homes and schools, relatives and grandparents deprived of family as a worker leaves in search of better job opportunities. These intangibles can never be measured."

While no one can recomense workers for these things lost as the industry changes, what I want to stress today is that so far, not one airline employee has had any protection, even of job rights. Not one has benefited from labor protective provisions enacted by Congress when it passed deregulation. Specifically,

1. Not a single airline employee has received the benefits of the preferential hiring provisions of the Act. In fact, final regulataions have not yet been adopted by the U.S. Department of Labor.

2. Not a single airline employee has received the income maintenance protection promised by the Act. Five years after the ADA's enactment, the CAB has only now scheduled the first hearings.

In light of this sorry situation, as one witness testified before this Committee, "the term 'employee protection' in relation to the Deregulation Act can be viewed at best as a cruel hoax upon the employees of the air transport industry." (Statement of William Mahoney, May 24, 1983 at 2).

I. THE COSTS OF DEREGULATION: ECONOMIC AND HUMAN

Former General President Frank E. Fitzsimmons firmly stated the IBT's opposition to airline deregulation back on March 25, 1977, when he stated before the Senate Subcommittee on Aviation, Committee on Commerce, Science and Transportation:

"We oppose . . . because we firmly believe that 'airline deregulation' or 'regulatory reform' as proposed, will lead to long-term unemployment, employee dislocation and hardship, lower wages, reduced benefits, and poorer working conditions for those workers lucky enough to retain their jobs in the transportation industry.

"In opposing . . . we believe that not only are we protecting the interest of our membership but also that we are acting in the public interest."

The easy entry and exit provisions of the Deregulation Act coupled with the elimination, for all practical purposes, of CAB regulation of air fares has seen these dire predictions come true. Airline employees have been the chief victims of deregulation. Even some in the industry have questioned the behavior of the airline industry since deregulation.

For example, Mr. Arthur C. Bass, Chairman of Midway Airlines (a nonunion new entrant) is quoted in The New York Times of June 3, 1983, as follows:

"The situation caused us to start taking a look at what opportunities there were for us in an irrational business," Mr. Bass said. Why irrational? "Well, what else can you say about an industry that loses $600 million in the first quarter and then engages in a price war to gain market share?" [advertising, Isadore Barmash, New York Times, June 3, 1983, Pg. D–15].

"Irrational" is also an apt term, in our opinion, to describe those airline managements and other representatives who support a law that is driving them towards bankruptcy. In the first quarter of 1983, eleven major air carriers operating in the United States posted a combined loss of $552.2 million. Not one of these eleven major air carriers had a profit in the three months ended March 31, 1983. In the first quarter of 1982, the combined loss of the same 11 major air carriers was $553.5 million, with one carrier posting a profit.

Following are the losses for the eleven major air carriers:

NET PROFIT AFTER TAXES

[In millions of dollars]

Airline	1st quarter 1983	1st quarter 1982
American	−$28.1	−$41.6
Continental	−57.6	−34.6
Delta	−39.5	−18.4
Eastern	−60.7	−51.4
Northwest	−20.9	−17.7
Pan Am	−79.6	−127.3
Republic	−58.9	−22.5
TWA	−92.7	−110.3
United	−94.5	−129.7
U.S. Air	−1.9	−10.8
Western	−17.8	−10.8
Total	−552.2	−553.5

"Aviation Week and Space Technology" May 9, 1983—pg. 29.

Even Delta Air Lines and Northwest Airlines, traditional profit leaders in the industry, suffered losses. Moreover, in the past few weeks the financial predicaments of Eastern, World, Capitol and Air Florida have received increased publicity. On April 22, 1983, Golden West declared bankruptcy; flight operations are not expected to resume.

The CAB's "Air Carrier Financial Statistics, Sept., 1982," shows that "Total Domestic" airlines had a net loss after nonrecurring items of $827.5 million in the year ended September 30, 1982. The loss for "Total major, nationals and large regionals" was $880.6 million for the year ended September 30, 1982.

Even the industry acknowledges that the financial problems facing the airline industry are attributable in large part to deregulation. A noted analyst of the industry, Julius Maldutis, Vice President of Salomon Brothers, recently stated in a speech given to the International Aviation Club with respect to the price wars in the industry:

"Since deregulation . . . in 1978, . . . [t]he linkage between costs and prices has been broken. The price of an airline seat has no relationship to the cost of producing it, but rather reflects the degree and nature of competition. . . . airline managements are seeking to lower costs in order to match prices.

"I respectfully submit that it was the managements of airlines that precipitated price wars. . . .

"I strongly believe that a new and more deadly form of price competition is underway.

"Evidence is mounting that some airlines are waging a far greater battle than is generally recognized. . . .

"The only acceptable reason I can find for the large divergence in individual carrier traffic results is that a more silent and deadly form of price competition is emerging." [Maldutis, "The Airlines: $99 Forever"]

David F. May, President and chief executive officer of Republic Airline, Inc., recently made similar comments about the destructive fare wars:

"A lot of the fares are very irresponsible fares. With the fare wars, *we are frittering away the concessions the employee groups have given us, as well as what equity we had to start with.* (emphasis added) We are weakening the airline system tremendously. * * *

"What you have got to stop is people pricing their product below what it costs to produce. The consumer is hurt by that. . . . The public probably is better served to have reasonable competition than to let the industry destroy itself to where there are only four or five major carriers left, all charging high prices." [Air Line Pilot, May, 1983, p. 8]

Others in the industry question the ability of airlines to survive under deregulation. For example, Melvin Brenner, a former executive with both American Airlines and TWA, and now a private consultant to the aviation industry, has expressed the view that while the recession and fuel prices are partly to blame for the turmoil in the industry, "deregulation has contributed immensely to the problem." In his view, as stated on the MacNeil-Lehrer Report on April 16, 1982 [Transcript pp. 3-4]:

"This industry has many of the characteristics of traditional public utility, and in a free market it tends into destructive competition, which we're seeing in the form of the price wars. It has very great difficulty in adjusting its capacity to the traffic when competition increases, and deregulation has increased competition greatly. This was evident throughout its whole history, and we are seeing it now with the kinds of losses the industry is experiencing."

As Mr. Brenner then further observed, the industry before deregulation, "had never had a situation where it had even two years in a row of operating losses. Now we are well into a third year in a row of serious operating losses. Secondly, the industry before has faced recession and jumps in fuel prices, and in the mid-1970's, after the Arab oil embargo, fuel prices jumped up just as sharply then as they have in the last few years, and there was a recession then. And the airlines did suffer a brief setback, brief and not very great. The new element today is not the combination of recession and fuel prices; it's deregulation." [Transcript, p.6]

Secor Browne, Chairman of the Civil Aeronautics board from 1969-1973 has also criticized deregulation. In a column appearing in USA Today on March 1, 1983, he wrote that the industry's massive losses are the result of destructive prices wars and overcapacity—"Too many seats chasing too few bottoms." In his view, the cash flow problems caused by this warfare are strangling the industry nearly to the point of self destruction. Only some form of regulation can save it.

In short, we fervently believe, as do many others in the industry that "airline deregulation has failed because it has not prevented a public utility from devouring itself." (Wayne Parrish, aviation journalist and publisher, quoted in USA Today. March 1, 1983, p. 4A).

If the burden of deregulation were reflected solely in financial losses borne by the carriers, then the situation would not be nearly as serious as it is.

However, in our view, the greatest burden has been borne by airline employees. According to the CAB, since December 1979 at least 40,000 full-time jobs have been lost in the air transport industry.

Employment	Full time	Part time	Total
October 1978	319,360	13,696	333,056
December 1978	327,236	14,059	341,295
December 1979	340,766	14,760	355,526
December 1980	330,292	13,421	343,713
December 1981	316,159	12,808	328,967
December 1982	299,265	14,455	313,720

(CAB Order 83-4-36, April 7, 1983, at p. 10.)

Approximately 10,000 people lost jobs in the Braniff bankruptcy alone. Over 5000 of those were employees represented by the IBT. The CAB's April 3, 1983 Order determined that since December 1979 at least nine carriers have suffered major contractions consisting of at least 7½ percent reductions in workforce. These include American, Pan Am, United, TWA, Continental, and Braniff. In addition, one of the first true low-cost airlines, World Airways, has furloughed about 27 percent of its workforce. Even before it reached this sorry state, in the Spring of 1982, World petitioned the CAB to restore partial rate regulation in order to prevent the ruinous price wars.

II. THE NEED FOR EMPLOYEE PROTECTION

The proponents of the Airline Deregulation Act argued that it would result in substantial economic gains in the industry, including an increase in the number of jobs in the industry. Nonetheless, as the Senate Committee Report reflects, it was acknowledged that some airlines might face difficulties in adjusting to the new regime and might, lose enough traffic to cause a major reduction in their total labor force . . . . Because the changes in the regulatory structure contemplated by this bill are in the public interest, it was felt that those who stand to benefit most from the new environment—the public—should be willing to assume the risk of employee dislocations that might occur and to bear the burden of reducing that risk by providing transition assistance to dislocated employees.

* * * the Congress, on behalf of the American people, must insure that the benefits to the public which result from its decision to alter substantially the regulation of air transportation are not paid for by a minority—the airline employees and their families who have relied on the present system. [S. Rpt. No. 95-631, 95th Cong., 2d Sess. at 114 (1978).]

Besides the labor protective provisions of the Airline Deregulation Act, the Civil Aeronautics Board, like other Federal agencies regulating commerce, has since the 1950's made the adoption of labor protective provisions a condition for its approval of inter-carrier transactions, such as mergers and acquisitions of control. These protective provisions provide for the negotiation and/or mandatory arbitration of seniority list integration, and offer certain minimum payments to employees who lose their jobs or are otherwise adversely affected by the transaction. Since seniority is a critical factor in work assignments and job security, seniority list integration is crucial in successfully joining the work forces of merging carriers. These protections are especially important under today's deregulated atmosphere which has apparently stimulated merger activity, in many cases to prevent insolvency.

Critics of labor protective provisions, whether those of the Deregulation Act or those imposed by the Civil Aeronautics Board in merger situations, argue that they constitute an intrusion into the collective bargaining process, and say the bargaining arena should resolve employment problems resulting from carrier transactions or industry upheavals. But, as we will show, collective bargaining alone is not sufficient to protect employees in these situations. Moreover, existing labor protective provisions are not sufficient to guarantee employees the rights envisioned by Congress against undue loss of employment, personal suffering and disruption in working conditions. In fact, the CAB's merger provisions will terminate when that agency sunsets on December 31, 1984. And, as for the purported guarantees under the Deregulation Act, the CAB has just now—five years after passage of the Act—gotten around to scheduling hearings on entitlements to labor protective measures. In fact, the CAB has erected so many obstacles to the realization of benefits that it

has effectively thwarted congressional intent and precluded the ability of workers to be compensated for their victimization.

To illustrate the inadequacies of the present legal framework to protect airline employees, I would like to draw from the experience which the Teamsters Union and its members have had in Texas International and Continental Airlines merger case.

In May 1980, the IBT was certified as the collective bargaining representative of approximately 1800 of Texas International's clerical, office, fleet and passenger service employees. The Union and the carrier then entered into a collective bargaining agreement which was to remain in effect until January 31, 1983, with automatic renewals unless amended in accordance with the Railway Labor Act.

During 1981, Texas International began purchasing an equity interest in Continental Airlines. By September 1981, the combined interests of Texas International and its parent company, Texas Air Corporation, in Continental exceeded 50 percent. At about the same time, the Civil Aeronautics Board approved the acquisition of Continental by Texas International and Texas Air Corporation. Between March 31, 1982, when the transition of corporate control to Texas International became effective, and October 1982, when the operational merger became effective, Texas International and Continental operated separately. Continental's approximately 4000 clerical, office, fleet and passenger service employees were unrepresented by any labor organizaiton, and worked under terms set unilaterally by management. Texas International's comparable crafts worked under their collective bargaining agreement.

Then on September 7, 1982, the two carriers announced that effective October 31, 1982, an operational merger would take effect with the combined entity to be known as Continental Airlines Corporation. Although Texas International would retain its corporate status, its operations and marketing identity would be completely integrated. The work forces would be completely integrated, with all employees, including those in the former Texas International clerical, office, fleet and passenger services craft or class, becoming subject to employment policies of Continental Airlines. In other words, the Texas International labor agreement and employee rights secured by it would have no further force or effect. In addition, the IBT was notified that effective October 31, 1982, Texas International intended to withdraw its recognition of the Union and to treat all employees formerly represented by the Union as employees of the combined airline, unrepresented by any labor organization.

On October 3, 1982, the IBT filed an application with the National Mediation Board seeking a representation election among the clerical, office, fleet and passenger craft or class of the post-merger Continental Airlines Corporation. This application is still pending. The IBT notified Texas International of its intent to negotiate changes in its collective bargaining agreement, in accordance with the contract and the Railway Labor Act, on October 18, 1982. Texas International rejected this overture to bargain as an "effort to reopen a closed contract."

Consequently, on October 28, 1982, the IBT filed suit under the Railway Labor Act in the United States District Court for the Southern District of Texas seeking injunctive and declaratory relief to prevent an imminent abrogation of the collective bargaining agreement. The Union maintained in that suit that, even if it is subsequently certified by the National Mediation Board after a representation election as the representative of Continental's office, clerical, fleet and passenger service employees, certain irreversible changes would occur that could not subsequently be remedied—for example, job losses, inability to adjust grievances, and lack of union input into decisions regarding workforce integration.

The district court dismissed the Union's lawsuit on January 30, 1983. In the court's view, the existence of the representation dispute among post-merger employees divested the court of jurisdiction over the contract abrogation and contract validity claims. No relief was available under of the Railway Labor Act. The case is currently on appeal to the Fifth Circuit Court of Appeals.

This litigation highlights the predicament faced by the IBT and its members at Texas International. Former Texas International employees have lost their contract rights, including their union representation, and the ability to secure redress of their grievances through a neutral grievance procedure. The carrier has effected changes in their terms and conditions of employment. Moreover, 2000 Continental and TI employees were furloughed in March 1983. Certain bumping into the system has been permitted, but solely at the employee's own expense; no relocation costs are reimbursed. The collective bargaining process is impotent to protect employees because, according to the district court, the carrier was immunized to arbitrarily and unilaterally renounce that system. Thus, the Railway Labor Act was not available to protect employees. Even if the Fifth Circuit Court of Appeals reverses, similar

misfortunes may occur in future merger cases. For this operational merger had unique features—particularly the survival of Texas International as a corporate entity after the merger—that may distinguish this case from later mergers where the smaller unionized carrier disappears entirely. In the latter situation, the courts might again believe themselves powerless under the Railway Labor Act to protect employees.

Even the CAB's labor protective provisions have not proven adequate to protect employees. To the best of our knowledge, not a single Continental employee who has filed an LPP claim has been compensated for losses. An example of Continental's response to an employee LPP claim depicts the bind employees are in:

As you are aware, certain conditions must be met before LPP benefits are due an employee. One requirement is that the employee's displacement, dismissal, reduction in force, or required relocation is caused directly by the acquisition. Displacements resulting from other causes such as the company's economic condition, normal fluctuations in staffing, termination of programs, or losing contracts are not covered by the LPPs.

Based upon our review of your particular situation, it is our opinion that your reduction to part-time was not due to the acquisition. It was due, rather, to the company-wide staff reduction that occurred in March due to the dire economic situation of the company following a poor holiday season and poor early winter. Therefore, it is our position that you are not due a dismissal allowance. Furthermore, even if the displacement was merger-related, you would not receive a dismissal allowance because you would have been able to hold a full-time position via a system bump.

Of course, as stated, if the employee had elected to system bump, it would have had to be at his/her own expense.

In addition, the CAB's merger provisions fail to guarantee the survival of existing labor contracts. In this sense they are sorely deficient, particularly as compared with protective provisions imposed by the Interstate Commerce Commission in railroad merger cases which do require survival of existing contracts. Surely, airline employees deserve the same treatment as railroad employees.

The TI Continental merger demonstrates that existing law is inadequate to protect airline employees from the adverse affects of mergers. We believe that the situation will be aggravated once the CAB sunsets and all merger protections disappear. For while the CAB's labor protection provisions are insufficient, they do at least provide an important avenue for dispute resolution in seniority integration matters. Without these procedures, it would be possible for a post-merger airline arbitrarily to oust the employees of one of the two merged carriers, irrespective of accrued seniority.

There is another point worth mentioning in connection with the TI-Continental merger. On October 31, 1982, the effective date of the merger, Continental Air Corporation terminated pension plans covering certain employees of Texas International and Continental. From documents we have obtained from the Pension Benefit Guaranty Corporation, it appears that on January 1, 1982 there were 6,530 active participants in the Continental Air Lines, Inc. Retirement Income Plan. Most of the active participants were nonunion ground employees in the passenger service classification.

Despite the protection supposedly offered workers by the Employee Retirement Income Security Act of 1974, and the CAB merger labor protective provisions, the company was able unilaterally to terminate a defined benefit pension plan established in 1957. To our knowledge the company has not yet adopted a proposed new defined benefit plan which it has promised to former Continental employees in various filings with the Securities and Exchange Commission.

The company used the "merger" of two of its subsidiaries, Texas International and Continental Airlines, as an excuse to capture pension assets. Thus, the Continental Air Lines Inc. Retirement Plan became a source of cash for Continental Air Corporation and its parent, Texas Air Corporation.

In Amendment No. 1 to Form S–3 filed by Texas Air Corporation with the Securities and Exchange Commission (received February 14, 1983) by the S.E.C. the following appears:

Pg. 4 "Texas Air's consolidated fourth quarter results reflect the sale of an office building by CAL which resulted in a $22,000,000 gain, as well as a *$25,500,000 gain from changes in actuarial assumptions* and the *termination of certain pension plans*." (emphasis supplied)

Pg. 8 ". . . Texas Air's results for the fourth quarter of 1982 reflect a gain of $19,000,000 attributable to the *withdrawal of $16,500,000 from the CAL pension plan* and to the recognition of a $2,500,000 gain with respect to the termination of the TXI pension plan." (emphasis supplied)

"The $16,500,000 received by CAL represents CAL's share of the excess, as of the termination date of the plan's assets over its liabilities * * * The plan had also provided generous early retirement benefits, which were discontinued upon Termination of the plan. A group of employees who are eligible for early retirement has claimed that those early retirement benefits should instead be satisfied through the purchase of annuities."

In a document filed a month later with the Securities and Exchange Commission, Continental Airlines Corporation made explicit note of the change in the early retirement provision procedure:

"The Company's results for the fourth quarter of 1982 reflect a gain of $10,500,000 attributable to the withdrawal of $16,500,000 from the CAL pension plan and to the recognition of a $2,500,000 gain with respect to the termination of the TXI pension plan.

The $16,500,000 received by CAL represents CAL's share of the excess, as of the termination date of the plan's assets over its liabilities . . . CAL and those employees have entered into a settlement agreement . . . Company will establish new plans providing similar early retirement and death and disability benefits for CAL employees who were participants in the former plan and will fund those benefits over several years, with a payment in 1983 of approximately $3,750,000.

Pg. 26—Form S–1 Registration Statement, Continental Airlines Corporation, to SEC (received March 18, 1983). Even with the additional costs of providing the early retirement benefit, the company will still emerge with $10.5 million from the unilateral termination of the Continental pension plan. To our knowledge the Continental employees still do not have any pension plan providing benefits for service after October 31, 1982.

On page 33 of the Form S–1 the company states that a proposed new pension plan (defined contribution) will be implemented to cover "all officers of the Company . . . along with substantially all other non-collective bargaining unit employees. . . ." But at least one officer of the Company has a much better pension arrangement.

Mr. Richard Adams (Senior Vice President) is entitled under his employment contract to a total annual retirement benefit . . . equal to 75 percent of his average annual contractual compensation out of the last five years immediately preceding retirement to the extent required to provide the foregoing benefit, the Company has agreed to supplement the benefits payable under its pension plan . . . If Mr. Adams retires at his current contractual rate, his annual retirement benefits will be approximately $126,000.

The generous pension made available to Mr. Adams contrasts starkly with the pension treatment of rank and file employees.

Continental, like many carriers in the industry has suffered heavy financial losses. Its participation in fare wars is directly linked to serious cash flow problems. To counteract these problems, Continental has attempted to lower costs by pursuing exploitive labor policies. This phenomenon is becoming increasingly prevalent under deregulation. Indeed, this entire Continental story, we believe, depicts graphically the vicissitudes of the deregulated environment, the plight of workers who make this vital industry run, and the plain inadequacy of the present legal structure to protect employees from victimization.

III. CONCLUSION

In sum, deregulation has had steep economic and human costs. The economic costs involve massive disruption in the airline industry, record losses, bankruptcies and severe cash flow problems. In fact, for many carriers, cash flow has become such a serious problem that fare pricing bears little relation to actual cost. The human costs consist of unemployment and the lack of effective protection for those who have been harmed by this massive economic dislocation. We opposed deregulation and still oppose it. But if the deregulation experiment is not to be ended now, as we believe it should, we would hope Congress enacts an effective, practical program to protect airline workers—and their families—from the injurious effects of the industry's apparent drive towards self-destruction.

We urge Congress, at a minimum, to codify the labor protective provisions now imposed by the CAB in merger and consolidation transactions. As stated, the seniority integration provisions are vital; they entail no cost to the government and little to carriers. Further, labor protective provisions should require maintenance of existing collective bargaining agreement in merger situations. Certainly employees deserve protection from their employers' whim and caprice in unilaterally eliminating valuable rights and benefits and altering terms and conditions of employment upon which workers have premised the employment relationship.

Finally, we ask that Congress establish standards for the labor protection provided in § 43 of the ADA which are sufficiently realistic and allow employees to avail themselves of the income maintenance and compensation remedies that are now due them solely in theory. Additional legislative guidance is required to assure that Congress' intent is carried out. In particular, we urge that present § 43, 49 U.S.C.A. § 1552(h)(2), be amended by striking the bracketed words and adding the underscored language as follows:

The term 'qualifying dislocation' means a bankruptcy or major contraction of an air carrier holding a certificate under section 1371 of this title, occurring during the first 10 complete calendar years after October 24, 1978, [the major cause of] *to* which [is] the change in regulatory structure provided by the Airline Deregulation Act of 1978 *contributed importantly,* * * *

These measures will not resolve the basic problems of deregulation—only some form of regulation of the industry to prevent irrational pricing will relieve these problems—but at least they will reduce the heavy burden that employees now shoulder.

Senator KASSEBAUM. The next witness is Linda Puchala.

It is nice to welcome you back again, and you are getting to be an old hand testifying at these aviation hearings, like everybody else, as a representative of the Association of Flight Attendants.

STATEMENT OF LINDA PUCHALA, PRESIDENT, ASSOCIATION OF FLIGHT ATTENDANTS

Ms. PUCHALA. Thank you, Madam Chairman.

I am the president of the Association of Flight Attendants, and we represent 21,000 flight attendants on 12 airlines. We do continue to represent the interests of the Braniff, the Air New England, and the flight attendants whose companies are in bankruptcy.

Madam Chairman, on behalf of our members I want to thank you for your role in easing our transition into deregulation by helping us continue to look at the CAB merger authority into 1985.

Our members average about 10 years of seniority. We are typically in mid-1930's, although we feel like we are getting older testifying and testifying. Half of us are married. One-third of us have children. Fifteen percent are male, and 85 percent are female.

Since deregulation we have experienced a 10 to 15 percent furlough among our work force, a rate compared to 1 percent prior to deregulation. And that figure, the 10- to 15-percent figure, would have been much higher if we had not instituted the union work-sharing programs among flight attendants.

The suggestion that deregulation would work better if the controllers had not been on strike, or if the recession had not occurred, and if the fuel prices had not escalated, or if interest rates would have stabilized implies that deregulation in a vacuum would have worked. As you know, no law has an opportunity to work in a vacuum and must continually adjust. When you cut away all of the excuses, you find that deregulation is not working, not only for the consumer but for the airline employee, because management cannot make it work, and those of us in labor have not been able to make it work.

The fare wars are only creating so much false traffic, and after that the low fares only serve to redistribute the passengers among the competing airlines. Fare wars have become a permanent fixture in the industry, and the airline analysts suggest that the competitive environment will be maintained because new entrant air-

lines are so desperate to stay in the market and established airlines are so desperate to maintain the cash flow.

The argument that deregulation has been helpful to the consumer because more flights and more discounts and more choices are available is disputed in my written testimony and has been disputed before you and by you today.

We flight attendants find that the passengers view the whole industry with suspicion, mainly because of the pricing. No wonder. They know that if they had traveled on a different day to a different city from a different city they probably would have been flying at probably one-half or one-third the cost.

Because the flight attendants spend the most time with the passengers in a restricted environment, we get to see the real impact of deregulation on passenger attitudes. To say that they are merely suspicious of those of us who work in the industry and the companies who pay our salaries is really an understatement.

Consider how you feel when you know that you had been taken for a ride on your ticket price. Then you get to the ticket counter and find that the direct flight has two stops and you thought it was nonstop. You check in. There are no seats available in the no smoking section. You get onboard the aircraft. There are more seats; therefore, the leg room is much more cramped, and the bracing position outlined on the briefing card is simply not doable. The meal service is cut or limited.

We witness daily discussions between flight attendants and the passengers over carry-on baggage. Their response used to be that they would cooperate with us. Now they get a little hostile with us. They argue with us about carry-on baggage. And when we used to have in-flight emergencies like heart attacks, people used to cooperate with us. Now they seem to be indifferent toward an in-flight emergency unless, of course, it affects them. The problem we have is that this indifference that seems to be mounting in the aircraft cabin takes its toll when you are trying to prepare people for an emergency evacuation.

The established airlines are cutting costs, and in concession negotiations our people are less likely and less inclined to consider the company's arguments because we feel we are only financing the fare wars. Since flight attendant compensation is less than 3.5 percent of airline operating expenses, our contribution toward turning a troubled airline around is not monumental.

As a part of the struggle to survive the harsh competition in the deregulated skies, the industry has extended its cost-cutting efforts not only to reducing labor cost, modifying route structures, and trimming passenger service, but also has extended its cost cutting into areas that passengers do not see. For example, in consultation with the airline companies, the FAA has proposed the elimination of the Federal requirement for crash, fire and rescue teams in the smaller airports. These teams were declared bottom line not to be cost effective. And one of the airports cited for elimination of crash, fire, and rescue teams was Cincinnati.

Airline companies have reduced the number of hours of first aid training for flight attendants, and CPR training is practically nonexistent.

I have some firsthand experience with the recurrent training program for flight attendants. Every year I used to attend 2 days of recurrent training. One day was for first aid. The other one was for emergency evacuation procedures. Then deregulation came along, and the company responded to the flight attendants' work environment that was changing. They recognized that passengers were becoming more hostile. So our recurrent training program included a course on "I'm OK, You're OK." Supposedly when we met up with hostile passengers we were not supposed to react in a hostile fashion. We were supposed to tell ourselves that we are OK and they are OK and go in the galley and kick the oven door or slam the trolley.

This was a genuine concern of the airline companies at the time. When the company came to us for concessions in the negotiations, they proposed eliminating 1 day of recurrent training; and after some caucusing, we decided that probably would be OK. We could compact the program, get everything into 1 day of classroom training, and read "I'm OK, You're OK" at home.

The training program, unfortunately, was so compacted that it eliminated virtually all reference to first aid training. We had no more CPR. There was a slide presentation on a new state-of-the-art fire extinguisher, but then the training supervisor qualified the entire presentation by saying that our company could not afford to purchase the new fire extinguisher.

A slide show on a newly configured aircraft was then shown. It was an aircraft that we were leasing, and it was termed a transition aircraft. So, therefore, we could not get too attached to where the emergency equipment was located.

The take-home booklet that we received in lieu of the second day of training proved to be absolutely wonderful. My favorite part of the test was a crossword puzzle with 300 entries. Here the marketing department certainly must have gotten involved, because one of the quiz questions was "What six-letter word comprises the name of the airline that is becoming our biggest competitor?" We thought the crossword puzzle was an extremely relevant addition to maintaining the high level of flight attendant safety training.

Cost cutting has also prompted some of the airlines to begin the process of operating in flight with less than the full air pac to save fuel consumption. This is occurring in the cabin only and not in the cockpit.

Under increased competitive pressure for ontime departure, aircraft are taking off more frequently before the flight attendant can complete the emergency equipment checklist. The aircraft flying over water are liberally granted exceptions that waive the requirement for carrying the liferafts. The Eastern jet which almost went into the Atlantic Ocean last month was carrying liferafts. However, Eastern did have an exemption not to carry those liferafts. In the airline cost crunch how much longer will carriers like Eastern be able to carry liferafts?

Airline passengers properly assume their ticket entitles them to certain intangibles: A safe trip; experienced qualified personnel in the cabin and the cockpit and in the maintenance shop. The Government, the airlines and ATA have different data, and we are all drawing different conclusions.

Deregulation has occurred at the expense of the airline employees, and my testimony outlines the extensive furloughs not only due to the bankruptcies but due to the shift in work among the airline labor force.

We testified when deregulation was proposed that we felt all deregulation would do would be to shift the work from the employees on the established airlines to the new upstart entrants, and that is exactly what we feel it has done.

Some of our employees are lucky enough to find jobs, including some of our Braniff people. I would estimate about 10 percent of the flight attendant force on Braniff has found employment in the industry. For those flight attendants who cannot be hired, they feel that they are back in the 1950's and 1960's when we faced the age discrimination. Many of our Braniff flight attendants had 12 to 14 years of seniority, and while it is difficult to prove, they know that they were not offered positions in the industry because they are over the age of 32 or 35.

Airline labor refers to the employee protection program of the Airline Deregulation Act as the greatest betrayal, and I know that you agree with us that in some respects it has been empty promises. And that is why I welcomed your comments this morning, because, frankly, those are the only encouraging words I have heard with respect to the employee protection program.

Airline employees cannot be expected to maintain the safety record in a deregulated environment with all of the competitive forces of the market which are eroding the quality of our daily decisions. We are going to rely upon you to help us all sort it out and to find a way to deal with deregulation of that effectively, and I welcome your questions.

Senator KASSEBAUM. Thank you very much, Ms. Puchala.

I am really kind of perplexed in the list of things that you went through, and believing that deregulation has ultimately caused a decline in service and safety and so forth, because I think I have heard that from several of the witnesses this morning. However, I go back to the earlier question I raised, that if indeed the purpose of deregulation is to make the airlines more competitive and serve the public better, they are obviously going to do things which they believe the public wants. And it is to their best interest to see that it be done well, whether it is safety or service, because if they do not, they are not going to succeed. There is nothing there that assures them a place in the marketplace like it did when there was regulation.

Those services could have been easily abused under regulation, and they would have been guaranteed still a place in the system. So I do not quite see how we can translate this back to deregulation with the force that you have made in your presentation or Mr. Mahoney in his, and others.

Ms. PUCHALA. Well, I think that in the years prior to deregulation we had developed a margin of safety. And as a prior witness has alluded to, we encouraged the airlines, not only the employees but the union, and we had roundtables with management, not only in the area of maintenance in the cockpit but also in the cabin, and sat down and had some hard looks at how we could improve the safety margin in the airline industry.

I think that we were very successful because the safety record is very good in the industry. However, what we are seeing right now is that the extra margin of safety that we have developed is slowly eroding. It is just one little thing after another.

Senator KASSEBAUM. Do you believe it is because of the cost-cutting aspects of the industry?

Ms. PUCHALA. As I cited the training programs, we went to concession negotiations, and the company said well, would you rather have a 3-percent pay cut, or do you want to give up some training pay? So we sat with the company, and we were as much a party as the company was to this, and tried to figure out a way to reduce training cost. Well, you reduce a day of training. You substitute a take-home book, with a flat amount of payment of $50, and the take-home booklet does not do the job for you. And we find—but we do not realize this until after the fact.

Now, we go back in and try and negotiate another day of training, and they are going to say come to training free, and so our membership is going to have to make a decision. And my concern when I look down the road is that flight attendants will have to pay for their own safety training, and we have our own ideas of how we are going to deal with that. But even safety training is a bargaining issue now, and it has not been in the past, and that is my concern.

When we look at preflight safety checks, we look at pressure gages in the evacuation chutes, and we assume that maintenance has checked these all out before we depart. And flight attendants now say they do not have the time to do it because we are trying to get an ontime departure. Well, the mechanics are faced with the ontime departure, too, and maybe they did not do the pressure checks on the valves.

Senator KASSEBAUM. But has that not always been a problem? I mean I would think any airline was trying for ontime departure prior to deregulation as well. I mean I do not understand.

Ms. PUCHALA. Well, I think what we used to face, Madam Chairman, was that there was not the hesitation on the part of the employee to say hey, wait a minute, if it means 2 or 3 minutes, too bad, we are going to do what we have to do.

Senator KASSEBAUM. But why would you not do the same thing today?

Ms. PUCHALA. Because the companies have developed even incentive programs for ontime departures. Flight attendants get bonuses in their paychecks for ontime departures. There is a pool, a bonus pool for ontime departures.

Senator KASSEBAUM. I am always pleased to see ontime departures myself, but——

Ms. PUCHALA. For 2 or 3 minutes, you know, for 2 or 3 minutes where an aircraft is being rotated on a 24-hour basis, you can imagine the setback with 2 or 3 minutes at each intermediate stop. And we, since deregulation, we are finding that we are maximizing the equipment rotation, which means that flight attendants in a 12-hour day before used to change aircraft maybe 2 or 3 times. Now we look at our schedules, and we see that we are changing aircraft as many as 12 times in a day.

You come in off a flight. Your outbound flight is already loaded there waiting for you to get onboard. You get onboard, relieve the inbound crew, and you are rolling and off on the runway. And I am saying that we do not have the kind of time that we used to have.

Now, maybe we ran into these problems before, but we were more confident in our dealing with them and putting our foot down and saying this is the way it will be. And I do not see that happening on the line now.

Senator KASSEBAUM. Well, I guess I would just wonder why you still do not put your foot down if that is a problem, because there evidently is a lapse of communication between employees and management in some of these areas, if indeed that is the case. Because I cannot believe an airline that particularly now is on such a cutting edge of competition is not going to want to utilize every facet of management skills in maintaining service and safety. It is to their advantage. It is to their advantage more, it seems to me, than it was before deregulation. And that is why I have such a hard time seeing why. I mean fare wars can certainly—this whole aspect of counterproductive flurry can pose problems, but I do not see it particularly causing these problems in safety and service.

I myself would rather pay a lower fare and not have extensive meals; and I think this is what the flying public is really saying. They just want maybe limited service but good service, but not necessarily all of the service that they have had in the past.

Would you not say that is probably an accurate reflection of what most of the flying public wants?

Ms. PUCHALA. Yes. I think passengers are concerned about getting from point A to point B, and I think that there are very few distinguishing characteristics in the market right now. Service certainly is not one of them. And so I think when we say that all the fares are doing is redistributing this traffic, that is all it is doing. People are traveling for a price. They are not necessarily traveling for service.

Senator KASSEBAUM Well, I do not know I necessarily agree with you there, because I certainly remember airlines that I travel on where indeed there has been pleasant service. Maybe it is not extensive. But I think you do remember an airline where people have gone the extra mile either in helping you with reservations or on the plane and in just a courteous way. I think it is very much a part of the success of an airline.

Ms. PUCHALA. But if that particular type of service costs you an extra $300 roundtrip, perhaps you would reassess the value of the friendly smile or the extra help from the reservation agent. And I think that is what is happening in the industry right now. People are trying to buy at a reduced rate, and that the distinguishing characteristics are being eliminated, and everybody is expected to be friendly and helpful simply because everyone needs the business right now.

But the main thrust of my testimony is that I do see this competition in the employee's mind between marketing and getting people on the airplane versus safety. And I am seeing it daily in terms of confronting it in concession negotiations but also confronting it on the line. And every one of us out there is expected to be a marketing representative, and that is frankly not what a passenger

is looking for if you dig a little deeper. If you decide in an emergency situation you can read 10 advertisements thanking them for flying your airline and telling them how many cities you serve, but it is not going to do them a hell of a lot of good if you do not have the background to get them out of the airplane safely.

Senator KASSEBAUM. I certainly would agree with you there.

Thank you very much, Ms. Puchala. We appreciate your comments.

Ms. PUCHALA. Thank you.

[The statement follows:]

STATEMENT OF LINDA A. PUCHALA, PRESIDENT, ASSOCIATION OF FLIGHT ATTENDANTS, AFL–CIO

Chairman and Members of the Subcommittee: I am Linda Puchala, President of the Association of Flight Attendants, AFL–CIO. We represent 21,000 flight attendants on 12 airlines.

Although some have described with glowing terms the effects of airline deregulation, my view as President of the nation's largest flight attendant union is less optimistic. Judging from the destructive impact on airline profits, the declining level of passenger safety and convenience, and the overwhelming burdens placed on airline employees, I can only conclude that deregulation has been a disaster.

Financial erosion

"There have been attempts to disassociate deregulation from * * * [the air industry's] financial results, i.e. * * * to place the entire blame on fuel prices and the recession. Such attempts stretch credibility. * * *

Attempts to white-wash deregulation ignore the examples of outright financial erosion that have occurred with the absence of regulation."—(Melvin Brenner, "Airline Deregulation: A Review After Two Years," Melvin Brenner Associates, Inc., January 1981.)

I won't dispute the negative impact on the air industry of the recession, high interest rates, and fuel price increases, all of which the industry has withstood in the past. The critical difference now is deregulation which has filled the skies with new airlines and resulted in unprecedented competition, excess capacity, and fare wars.

Brenner's 1981 study found that deregulation—not fuel prices or recession—was responsible for the industry's financial erosion. As he pointed out, airline earnings started to drop in the first quarter in which deregulation was enacted, 6 months prior to the 1979 surge in fuel prices. And in the early 1970's, CAB regulatory actions cushioned airlines from the effects of fuel price increases and recession by imposing a moratorium on new route awards and approving capacity agreements.

Now, without regulation in the worst recession in recent history, airlines are without any protections. Instead they face an environment of virtually free entry of competitors on any route, a glut of empty seats, and cutthroat fare wars, as well as the general economic burdens of the recession which all industries are facing.

Recent data confirm Brenner's earlier conclusion that deregulation is the critical element in present airline performance. In 1982 the scheduled airlines suffered record losses of nearly $1 billion. These remarkable losses occurred in spite of a drop in interest rates, a 4-percent increase in traffic, and a $770 million drop in fuel costs.

Profit margins of "trunk carriers" (now called "majors") were negative only one out of 22 years prior to deregulation, according to the CAB. Since deregulation, however, they have been negative 4 out of 5 years. These recent profit margins are actually worse than the statistics suggest, because they include a number of steps by airlines to increase profits, such as selling assets.

The rate of return on trunk carriers' stockholders equity was −3.7 percent for 1981, and −15.1 percent for the year ending June 30, 1982, according to CAB figures. This statistic had been negative only three times during the 22 years prior to deregulation. By contrast, all manufacturing industries averaged 11.5 percent return on equity for the year ending June 30, 1982, and have shown no negative rates in 27 years.

Perhaps the bottom line of the industry's financial erosion since deregulation is the growing list of airlines filing for bankruptcy or ceasing operations since 1978. That list now includes Overseas National Airways, Air New England, Airlift, Apollo

Airways, Golden Gate, Swfit Aire, Braniff, Altair, Air Chaparral, Golden West and Air Hawaii.

Excess capacity and fare wars

Other airline analysts have identified the intensely competitive environment under deregulation as the source of the industry's ills.

"The intensely competitive nature of the industry in recent years has worked to limit profitability for almost everyone."—(Edmund Greenslet, V.P., Merrill Lynch quoted in Aviation Daily, August 6, 1982.)

"Excess capacity and unprecedented competition have caused noncompensatory fares to become the rule instead of the exception on many major routes."—(H. C. Munson, V.P., Strategic Planning, Boeing, quoted in Aviation Daily, March 18, 1982.)

There is no doubt that deregulation has filled the skies with new competitiors for established airlines. The number of certified, scheduled passenger carriers has expanded from 36 to 98 in the past four years, with 22 of those nonexistent prior to deregulation. Major carriers have suffered the worst as they have lost significant market shares to these new competitors attracted to the "glamorous" long-haul routes. The majors' share of RPM's dropped from 95 percent to 85 percent from 1978 to 1982 due to the phenomenal growth of new and smaller carriers.

Under regulation, the CAB had created a distance-based formula for standard fares and greatly restricted the use of discounts. Now excess capacity caused by deregulation has broken the link between costs and prices, and fare wars have become a permanent fixture. Now adults fly for box tops and "kids fly free." In 1978, 48 percent of passenger flying was on discount fare, with an average 34 percent discount. Now approximately 80 percent of passenger flying is discounted an average of 45 percent, according to the ATA.

Heavily discounted fares are suicidal—they may increase traffic, but rarely enough to increase yield. Industry observers note that the recent $99 transcontinental fare is inadequate to cover costs, even at a 100 percent load factor. Despite load factors of almost 60 percent last year—the highest in all but 3 years of jet age history—major carriers suffered record losses.

The growth in heavy discounting has had the additional effect of eliminating the historical distinction between the full-price business traveler and the cut-rate discretionary leisure passenger. The pricing trend is away from restrictions and capacity controls, which means almost every passenger buys the lowest fares available. This redistributes traffic flow patterns and makes intelligent schedule planning difficult.

Economists have explained why the industry is engaging in apparently irrational suicidal price wars. Airlines cannot store their product as manufacturers can, and wait for excess capacity to dry up. Since the marginal cost of selling an otherwise empty seat is close to zero, there is no floor to the discount a carrier can afford to offer if that discount will lure a paying passenger into an otherwise empty seat. In the current environemnt, a carrier can generate new traffic only by taking it away from another airline.

The price structure is now determined by new low-cost carriers which use discounting to carve out their niche in a given market; Southwest, for example, entered markets with fares 50 percent below prevailing coach fares. Prices are also determined by financially marginal carriers which use discounting to generate cash, as in the case of Pan Am which offered unrestricted $99 fares virtually anywhere in the U.S. last winter.

Other airlines have been forced to follow suit, even at a loss, in order to protect their market share and the landing slots they risk losing if they withdraw from a route. Because established airlines have responded to the competitive threat of new entrants, the "upstarts" have more impact on the industry than their size or numbers would suggest.

A truce to the fare wars in the form of mileage-based fares was recently proposed by American Airlines and supported by much of the industry. With no CAB enforcement, however, the effort is futile. In fact, only two weeks after American's announcement, Pan Am, which had shown a net loss of over $900 million over the past two years, introduced fares of 17-53 percent below competition, and the fare battles continue.

Free market pricing under deregulation is not working. I urge Congressional inquiry into mechanisms to allow airlines to set rational prices based on cost and distance. Statutory or privately endorsed "zone of reasonableness" guidelines would assist the industry in achieving the stability it desperately needs.

Disruption in passenger service

"The one over-riding fact [in air service patterns] is that there has been great disruption, and almost continuous change."—(Melvin Brenner, op cit., p. 7.)

In many cases, the quality of air service to small commuters has deteriorated since deregulation as major or national carriers withdraw from these markets and are replaced by commuters. A CAB survey of service to 536 nonhub airports found that between June, 1978 and June, 1981 they experienced a 34 percent decline in jet departures, a 20 percent drop in large prop plane departures, and a 13 percent increase in small prop plane departures. Unfortunately, the service provided by the commuters is often less reliable and more expensive than that available 5 years ago, and hardly seems responsive to consumer demand. For instance,

Some ski resorts in northern Michigan are now serviced only by aircraft without the capacity to carry skis.

Prior to deregulation, North Central (now Republic) boarded 1,400 passengers each day at the Marinette, Wisconsin—Menomonee, Michigan Airport. Tickets cost $4.00 to Green Bay and another $26,000 to Chicago. The airport invested some $10 million in local, state, and federal funds for airport improvements in anticipation of this continuing level of passenger service. After deregulation, Simmons Airlines replaced Republic when the latter dropped service to this community. Simmons doesn't fly to Green Bay, so passengers now ride a van there for $30.00 instead of flying there for $4.00. A ticket to Chicago now cost $99.00 instead of the previous $30.00 and the scheduling is less reliable. Passenger boardings have dropped to only 70 passengers a day. But passenger service has not been the only casualty. Air freight service has also suffered. Air freight service has also suffered. The Simmons planes lack the cargo capacity of their predecessors, so trucks now provide the only cargo transport for the local boat and paper industries.

When Golden Gate and Swift Aire suspended Service in the fall of 1981, six California cities—Stockton, Modesto, Merced, San Luis Obispo, Santa Maria, and Bakersfield—were left with virtually no service.

When United pulled jet service out of small California cities, three dozen new air services entered the markets to join the 19 already there in 1978. By 1981, only 27 remained. From month to month passengers and travel agents had no idea who would be flying what schedule to a particular city. Merced had 16 schedule changes in 18 months; Modesto experienced 18 changes in 15 months as well as 3 air carrier bankruptcies. This erratic, unreliable service has taken a toll on business: passenger departures from Merced, Stockton, and Monterey dropped by more than 40 percent in the three years following deregulation.

Even the widely touted benefits of deregulation for long-haul passengers—bargain fares and added service—are fraught with confusion. Long distance passengers are indeed paying less for their tickets now, but are befuddled about what the ticket price really is. One major travel agency estimates that 15,000 domestic air fares change each day. One of my staff called 5 airlines and one travel agent last month to ask the cheapest fare from Washington to San Diego. She received 4 different price quotes ranging from $318 to $499. Four of the airlines reported only their own rates, none of which were actually the lowest, and the travel agency failed to mention the lowest rate at all.

Employment reduction

Deregulation has occurred at the expense of airline employees who have experienced furloughs, been tranferred to different bases as routes are restructured, and accepted pay cuts and work rule concessions. Too many employees have also suffered the ultimate loss of their jobs to bankruptcy.

Since 1980, total airline employment has dropped by 37,000 people, or 32,000 on major carriers alone. The CAB reports that total employment on major carriers contracted 1.7 percent in 1980, 5.6 percent in 1981, and 6.5 percent in 1982. This contrasts to the employment record for the 20 years prior to deregulation, in which only 6 years showed employment declines, averaging only 1.7 percent.

Sadly, the very mechanism which was designed to soften the burden of deregulation on labor has failed to operate. The legislative history of the Airline Deregulation Act plainly intends that statutory protections, including financial assistance, be provided certain airline employees who lost their jobs through reductions in force, the major cause of which was deregulation. Although these labor protections were clearly mandated by Congress to cushion airline employees from the negative effects of deregulation, LPP's remain empty promises. Congress has not yet funded the program; the Department of Labor has not yet finalized regulations to implement first-right-of-hire protections and displacement allowances; the CAB has yet to hold evidentiary hearings to determine that employment contractions on nine airlines are

attributable to deregulation; and the CAB has recently required more strigent data from applicants who will seek that determination. (Ironically, analysts have been less able to provide this data because part of the deregulation process has eliminated much information formerly reported by airlines to the CAB.)

Flight attendants as well as other airline professionals have been the victims of deregulation. Flight attendant furloughs have soared since October, 1978. At that time, only 200 flight attendants were on furlough according to surveys of the Future Aviation Professionals of America. One year later the number had grown to 1,150. In October, 1980 there were almost 3,300 on furlough; in October, 1981 more than 4,000; in October, 1982 almost 3,200. This March the figure stood at 3,900. In the past three years approximately 6–7 percent of all flight attendants have been out of work, and rarely in the last few years have less then 10 percent of AF members been on furlough status.

Some of the luckier employees are finding new jobs on other carriers. A job shift is costly even within the industry, however. The importance of accrued line seniority reduces mobility within the industry because lost seniority means lower pay and reduced bidding rights. Job losses for our members mean severe disruptions of both their professional and personal lives. Our members have an average 10 years' seniority invested in their flight attendant careers. They are typically in their midthirties; approximately one-half are married, one-third have children, and 85–90 percent are female. Lost jobs for these people not only means lower pay, seniority, and bidding rights in a new flight attendant job, but often requires selling homes, relocating families, or reluctantly embarking on new careers when they're pushing the age of forty.

Furloughs are not the only penalty of deregulation. As established airlines have restructured routes and modified operations in the deregulated environment, they have reduced or closed bases forcing flight attendants to tranfer to new domiciles or to commute (fly to and from the job).

Since 1980 more than 1,300 of our members have suffered this disruption as 4 airlines have closed a total of 11 bases. (This does not count 2,900 flight attendants on the 4 Braniff bases closed last year). A fifth airline has announced plans to close another base next month, displacing another 30 flight attendants. This contrasts with the 4 years prior to 1980 when no AFA bases closed.

Another 13 flight attendant bases on 4 AFA carriers have reduced their active flight attendant staffing by more than 1,100 people since October 1978. Sometimes these base reductions represent transfers of crews to other bases; sometimes there is no offsetting growth on another base in the system, resulting in net decline in staffing.

What do these base closures and reductions mean? They mean disruption of more than 2,400 lives as flight attendants must move households and families to new locations or become long-distance "commuters" who fly between their home cities and their flying jobs. Moving is the more serious alternative, especially for flight attendants with homes to sell or spouses who work. Commuters, however, must fly an additional 8–10 hours each trip just traveling to and from their jobs, thus extending some work days to 12–15 hours.

Unfortunately, flight attendant commuters are a growing trend. Republic's Detroit flight attendants were only 10 percent commuters in 1978, but are 50 percent now. United Airlines' Chicago base had an estimated 30 percent commuters in 1978, but 50 percent now. More than 80 percent of the Western flight attendants serving Salt Lake City are commuters.

One final word about the burdens placed on airline employees: Analysts have pointed out that the hostile environment created by deregulation, coupled with the recession, has placed a premium on previously unneeded and often undeveloped airline managerial skills. As part of their learning process, managers are too often making errors in their efforts to cut costs and squeeze every nickel out of the operation. Using the easy mobility that has developed among airline managements, they are frequently abandoning ship and jumping to other companies. Line personnel, on the other hand, have little mobility within the industry. Professional line personnel are the people who are paying for management's mistakes through furloughs, base closings, concessions, and bankruptcies.

Labor costs

Many have claimed that deregulation has encouraged the creation of airlines with lower pay and higher productivity. Despite its current emphasis, however, increased airline worker productivity is nothing new. For 20 years prior to deregulation not only did the number of airline employees per revenue ton mile (RTM) fall continually, but the number of trunk employees per RTM fell more sharply than the number

of manufacturing employees per unit of output over the same period, according to the CAB.

Lower labor costs are undoubtedly an important cost advantage for new entrants. Their labor cost differentials will narrow, however, as their junior work forces increase seniority. Remember too that these lower payrolls reflect lower output or service than established, "higher-priced" labor produces. New entrants typically provide less service in baggage handling, food, and ticketing. I will mention later that they also may provide less passenger safety.

Airlines are indeed trying to create lower payrolls for their workforce. In the past two years flight attendants and other labor groups on at least a dozen airlines have agreed to pay freezes, pay cuts, and/or benefit reductions demanded by carriers to reduce operating costs and improve their competitive advantage. Since flight attendant costs typically represent less than 3.5 percent of an airline's total operating expenses, flight attendant wage and benefit concessions provide dubious cost-cutting relief. Nevertheless, if companies are in survival modes, flight attendants have recently agreed to do their part in cost-cutting efforts of many airlines.

Former Braniff employees know that employee concessions may be a futile effort, however. Braniff workers made significant concessions when the company's financial problems became evident more than a year before it filed for bankruptcy. At its demise Braniff had trimmed its costs to 7.2 cents per seat mile, one of the lowest in the industry. Despite the sacrifices of its employees, however, it filed for bankruptcy last May.

On the subject of labor costs, I also want to comment on earlier public statements by the ATA which have implied that airline workers are overpaid. The ATA has stated that average airline employee compensation is $39,000, or 70 percent higher than the average U.S. pay of $23,000. This comparison is misleading in several ways. First, the figure for average airline compensation was calculated by dividing total labor-related costs by total employment. This includes non-compensation items such as employee expense reimbursements and training costs as well as salaries and benefits. Second, it is biased upward by including equally the $400,000 salary of a CEO and the $15,000–$26,000 salary of a 6th-year flight attendant. Remember too that the airlines require a large proportion of highly skilled—and adequately compensated—professionals.

Finally, the average U.S. compensation may be higher than ATA's $23,000 estimate. For example, according to the Commerce Department's Current Population Survey, the average 1981 salary was almost $19,000 for all U.S. workers. Adjusting for the cost of benefits, the average compensation approached $26,000 in 1981, and increased in 1982 to narrow the gap even further.

Impact on safety

As part of the struggle to survive harsh competition in the deregulated skies, the industry has extended its cost-cutting efforts not only to reducing labor costs, modifying route structures, and trimming passenger services such as food, ticketing, and baggage handling. The airlines are also cutting costs in ways that passengers don't see—ways which may reduce the level of safety. For example:

The FAA is considering elimination of a federal requirement for crash/fire/rescue teams at smaller airports. An FAA-commissioned study declared these teams not to be cost effective.

Several airline companies have reduced the number of hours of first aid training for flight attendants, and most CPR certification training has ceased.

More inexperienced and first-time air passengers are unfamiliar with carry-on baggage rules, and baggage monitoring at the gates had decreased. This results in stowage problems in the cabin as baggage racks and closet storage areas must accommodate more weight then they were safely designed to hold.

Airlines have begun the practice of operating in flight with less than full air pacs to save fuel consumption. This is occurring in the cabin only, not in the cockpit. Flight attendants and the public are subjected to greater contaminants in the air.

Flight attendants have reported an increase in passenger assaults upon cabin crew members. More crowded airline cabins may increase passenger frustration and hostility.

Under increased competitive pressure for on-time departures, aircraft are taking off more frequently before completing a check of all safety equipment.

Flight attendants are working more overnight flights and longer duty periods, often without adequate rest, and employers are requiring crews to fly additional short trips immediately after completing all-night flights across several time zones. Fatigued flight attendants are less alert and less able to react in emergencies. Pilot crew members who share the same schedule suffer similar fatigue.

Aircraft flying over water are liberally granted exemptions which waive the requirement to carry life rafts. Airlines are seeking this exemption to avoid the expense and added weight of rafts. The Eastern jet which almost crashed into the Atlantic last month could have been operating without life rafts, and in February the FAA turned down a proposal for more stringent flotation equipment requirements, partly because of their cost. How much additional safety equipment will be deemed not cost-effective?

Airline passengers properly assume that their tickets entitle them to certain intangibles: a safe trip, and experienced qualified personnel in the cockpit, in the cabin, and in the maintenance shop. New low-cost carriers have less experienced personnel than established carriers. Flight attendants on AFA carriers, for example, have flown an average 10,000 hours and offer to passengers their valuable but intangible experience in handling a variety of emergencies—heart attacks, first aid, hijackings, difficult passengers and emergency landings. By contract, flight attendants on new carriers which took to the skies since deregulation have flown an average of only 3,000 hours, and can offer less safety value to the traveling public.

What is the future of the airlines under deregulation?

We see no end in sight to company demands for labor to subsidize airline operations through employee concessions. Unions may more frequently demand employee stock ownership programs and seats on company boards in return for their sacrifice of hard-won pay and work rules.

We may see renewed assaults on the quality of air service similar to the FAA's recent Regulation by Objective proposals.

We may see the development of anti-trust problems in major airlines' use of automated reservation systems and their ability to influence decisions on whether upstart airlines can gain access to airport terminal and gate facilities.

We are skeptical of any predictions for a turnaround in the near future because similar optimistic predictions over the past 18 months have failed to materialize. Unfortunately, I must agree with those who predict that the industry will suffer the pangs of deregulation for many more years. There are likely to be additional mergers, the emergence of more new low-cost carriers, continuing excess capacity and fare wars which will depress yields, continued high levels of unemployment, and possibly the demise of one or more financially marginal airlines.

Thank you.

QUESTIONS OF SENATOR HOLLINGS AND THE ANSWERS THERETO

Question. In your testimony, you discussed cutbacks in recurrent training, which included first aid training, since deregulation. You characterized this as the airlines having made safety training a bargaining issue. Is that correct? If so, how widespread is this situation?

Answer. Flight attendant first aid training has been reduced on United, Republic, Hawaiian, and Aloha Airlines; training in CPR has been discontinued on Republic and Hawaiian Airlines.

In recent flight attendant contract negotiations on Alaska, Republic, Texas International, USAir, and United Airlines, the companies have proposed the reduction of pay for the time flight attendants spend in recurrent training. This reflects the companies' declining emphasis on classroom training and the trend toward substitution of less expensive, unsupervised self-training. On Republic, for example, "self-walk-throughs" have replaced the supervised inspection/orientation to aircraft, and hands-on experience in jumping out of escape chutes has ceased entirely.

Question. Could you please discuss the extent to which the airlines offer incentive programs for on-time departures? In your opinion, has the development of these incentive programs in any way hindered airline safety? Are there any reprimands given by the airlines for not making departure schedules because of necessary safety checks by flight attendants?

Answer. Our flight attendants on Texas International Airlines experienced an incentive program for on-time departures and landings for approximately six months early last year. During this program, the airplane doors would sometimes be shut before the flight attendants were ready, and the plane would begin to push back while passengers were still standing up and storing their luggage. Landings sometime began before flight attendants had competed the service pickup, despite flight attendant complaints that the cabin was not yet secure. Meal trays were still down and the galley was still unlocked. Federal Aviation regulations prohibit take-offs or landings until the plane is secure; they require a plane to circle an airport and not to land until the cabin is readied. The company paid bonuses to the flight and cabin

crews for meeting schedules and for saving fuel by reducing airport circling time. We believe safety was compromised for efficiency, however. I don't know of any reprimands given by airlines for not meeting schedules because of flight attendants safety checks.

Senator KASSEBAUM. Mr. Krueger, it is a pleasure to welcome you as Associate Director of the Resources, Community and Economic Development Division of the General Accounting Office. And if you would like to introduce those who are accompanying you.

STATEMENT OF OLIVER KRUEGER, ASSOCIATE DIRECTOR OF RESOURCES, COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY THOMAS REESE, GROUP DIRECTOR; AND ROBERT TICE, SENIOR EVALUATOR

Mr. KRUEGER. Thank you, Madam Chairman.

On my right is Mr. Thomas Reese, group director in charge of all of our work at FAA and CAB, and Mr. Bob Tice who did this particular job for us on the effects of deregulation.

My prepared statement has been submitted, and I have a real brief version here I think I can get through in 5 minutes.

Our report on this matter will be issued in a matter of a few days. It has been signed by the office, and we had hoped to have copies here this morning, but it is not quite out yet. It will be a couple of days.

Our current report is the fourth in a series of reports that we have issued on the airline industry operations. It is intended to take a snapshot of the airline industry before and after the act's passage.

In the first 2 years after deregulation, economic indicators were rising and the airline industry experienced moderate air fare increases, substantial air passenger travel growth, and broad-based gains in departures, available seats and flight frequencies compared with the years before deregulation.

In the next 2 years the airline industry was buffeted by the combined effect of recessions, rapidly rising fuel costs and the air traffic controllers' strike, all of which led to an erosion of the first 2 years' gains.

In 1982 the economy was in the third year of the recession, and the airlines' profitability continued to decline. The first 3 months of calendar year 1983 shows air traffic is increasing, but airline profitability is still declining.

Since deregulation began, airline traffic in terms of revenue passenger miles and total passengers increased substantially. The average annual increase in passengers since deregulation was 9.3 million, while the annual increase in the 5 years before deregulation was 11.5 million.

In the period before deregulation, air fares per passenger miles rose by 33 percent, and airline costs rose by 72 percent. In the 5-year period after deregulation began, the average fares per passenger mile increased by 46 percent while airline costs rose by 87 percent.

In 1982 air fares fell 6 percent while airline costs rose only 2 percent.

The domestic airline industry's rate of return on investment fell to a 7-year low in 1982. By contrast, the industry had a decade-high rate of return on investment in 1978 and an above average return in 1979.

In 1982 one of the industry's major airlines, Braniff, and two other smaller airlines declared bankruptcy.

Improved airline productivity and favorable economic conditions were two major factors that contributed to airline profitability in the 1978 and 1979 period. In 1982, despite the third year of recession, airline productivity improved. Part of the gains, however, resulted from price discounting, which although increasing passengers and load factors, did not improve the airlines 'profitability.

During 1982 airlines were able to increase the percentage of available seats sold above the average load factor of 55 percent for the 4 years before deregulation. With airlines making increasing use of discount fares, load factors rose slightly in 1982.

Since deregulation, weekly departures and available seats have increased at all but the smallest communities. The growth in their air service is marked by sharp gains from 1977 through 1979, broad-based declines from 1979 through 1981, and some renewed gains in 1982.

Communities of all sizes benefited from the renewed gains during 1982. Since deregulation, however, only the smallest communities have suffered declines in departures and available seats.

Changes in air service patterns have not affected all geographic areas equally. Twenty-seven States had increases in weekly departures and available seats between 1977 and 1982. The remaining 21 of the contiguous 48 States and the District of Columbia had a decrease in departures and/or available seats.

During 10 ten years before the act was passed, 137 communities lost all certificated air service. As of December 1982, CAB was subsidizing air service to 3 of these communities, and 14 others were receiving unsubsidized air service.

The Airline Deregulation Act guaranteed essential air transportation for 10 years to small communities that were receiving air service on the date of the act from a certificated carrier. We recently issued a report to you on this program. In that report we suggested that Congress consider changes to the program to allow CAB to help some communities develop markets using higher subsidies or to discontinue subsidies to communities unlikely to support air service.

Of the 203 small communities that were receiving service on the date of the act from noncertificated carriers and were therefore not eligible for essential air service protection, 102 of those communities, or 50 percent, have lost all air service since deregulation.

According to studies by the Secretary of Transportation, there was no evidence that deregulation had adversely affected air safety in 1979, 1980, or 1981.

The fourth report, which will cover 1982, has not yet been issued. Air traffic statistics, however, for 1982 indicate the certificated airlines lowered their overall accident rate. However, two major fatal accidents—the Air Florida crash in Washington and the crash in Kenner, La.—raised the 1982 fatality rate significantly above that

of 1981. Commuter airlines cut their fatal accident rate and fatality rate by about one-half in 1982 compared with 1981.

Madam Chairman, this concludes my statement.

Senator KASSEBAUM. Thank you very much, Mr. Krueger.

You ended on the comment regarding safety. Do you believe from your studies that you can trace the safety factors to deregulation? Do you see a tie between the competitive thrust of deregulation and an effort to cut corners that might jeopardize safety?

Mr. KRUEGER. We listened to some of the testimony this morning. Our review of the last 4 years has not gotten into those types of matters. I do not know whether you could prove them conclusively. I know some of those charges were made before the act was passed that those things would happen; there would be a cutting of maintenance and so forth. We have no evidence of that.

Senator KASSEBAUM. In your assessment you say the profitability is declining. Do you attribute this to the large percentage, 80 percent of travel due to discount is discount fares? Would you think that would be a factor in the profitability?

Mr. KRUEGER. I think it definitely is. As I just said in my statement, in 1982 even though the number of passengers has gone up—I think 298 million passengers in 1982—the airlines were still losing more money. And obviously, when you charge less to carry people, you are going to lose more money unless you can reduce cost. They have not been able to reduce cost that significantly.

Senator KASSEBAUM. Those ratios have been, the 5-year ratios, are approximately the same as before, as I was adding it up.

Mr. KRUEGER. On the rate of return?

Senator KASSEBAUM. Yes.

Mr. KRUEGER. The rate of return on an overall basis is about the same, before and after deregulation, but if you look at each year since 1978, it has gone down significantly from about 7 percent, 6 percent, 5 percent, now down to—in 1982 what is the figure—3.3 percent in 1982. So it has gone down steadily every year.

Senator KASSEBAUM. What do you see from your assessment—and maybe this is something you would not feel that you could comment on—what do you see as some ways that this can be improved? Is it largely going to be a question of the industry itself coming to terms with their competitive drive and the instability that exists there right now?

Mr. KRUEGER. This is a personal opinion, if you will, and maybe my colleagues would like to chime in. It would seem to me that when you are going through the throes of deregulation like the airline industry has, it is going to take a period of time to work itself out. I am not sure we are quite at that point yet.

Tom, would you like to add anything to that?

Mr. REESE. No. I think that is correct. I mean you take an industry that operated for 40 years in a regulated environment and you put them into a deregulated environment, it is going to take a while to decide which way they want to go. But it is going to be very difficult.

Senator KASSEBAUM. I do not know if you were here at the very beginning with the first panel of witnesses, and I was asking Mr. Ignatius and Chairman McKinnon about the proposal that has

been made by some and one of the airlines itself as far as the zone concept and the percentage ratio fare per mile.

And I do not know if you were here at that time and heard their answer. Chairman McKinnon seemed to believe it would actually wreak more havoc, and that if you did have a zone concept, it would possibly force people out rather than actually helping the competition be more competitive.

I do not know if you have really done any studies on that.

Mr. REESE. No. We have not looked at any of those proposals.

Mr. KRUEGER. I think the only information we have on the different types of fares would be in the essential air service report where we do show a lot of those communities are obviously paying some very high fares to go very small distances.

Senator KASSEBAUM. And would you agree with the assessment that that is because there is a small passenger load there, and the high cost of operating that plane, those fares are going to be high?

Mr. KRUEGER. I think that is generally true, even though they are, under the essential air service program, using much smaller planes. As some of the witnesses testified, your costs would be much lower; but they still must be very high in order to charge those fares plus throw the subsidy in on top of it.

Senator KASSEBAUM. Do you see anything from your studies to indicate some suggestions that you would make for improvement?

Mr. KRUEGER. In the essential air service program?

Senator KASSEBAUM. Well, yes. First in the essential air service program and then actually as far as if there is anything legislatively that we can do to help. And I do not know that there is. I do not know that I believe that there is. I would be curious for your comments to improve the stability of the situation.

Mr. KRUEGER. I do not believe we have any recommendations dealing with the overall deregulation issue. I think our previous comments that it will take time to work out, and it obviously is getting to a better situation now.

We did have some specific recommendation with the essential air service program. We recognize that the program was set up to guarantee essential air service to those communities for a period of 10 years. Looking at that program now 5 years down the road, we see very little likelihood that air service will continue in most of those communities after the subsidy stops.

The passenger loads have decreased by over 50 percent. There are a lot of larger airports that are close by these communities getting subsidies. You can drive that 40 miles and get much better service, lower fares and go places where you want to go without having to go a circuitous route.

So we are recommending that the Congress consider changing the criteria for the essential air service subsidies. We recognize that would be a complete change in the program as it was originally intended.

Senator KASSEBAUM. Well, I think from the earlier discussion that there certainly are many of us who believe we need to look at that criteria, believing strongly in essential air service for many communities, and yet with the pattern that has developed, it is proving to be a hardship on the community just as much as it is a

need. And I think as we try and fit it in to the full concept, it will take a reevaluation.

Mr. KRUEGER. I think we also show in our report at least some examples of where there are some, shall I say, more deserving communities due to population shifts and so forth that could use a subsidy to get airline service started and are not able to do so under the program.

Senator KASSEBAUM. Do you think that the passenger traffic has dropped so dramatically because of say distance? If you can drive 40 miles and catch a plane, then the cost of using the commuter service is just way too high.

Mr. KRUEGER. I think that is obviously one of the factors. Some of the other factors that I believe—I think one of the other witnesses alluded to this—involve the fact that prior to this, the communities were served usually by a larger aircraft. Now there is service by the small 9 to 30 passenger commuter-type aircraft. A lot of people do not like that, and the fare differential is worthy of that 40- to 50-mile drive, plus the overall economic recession. I think that for a couple of years there were just not that many people flying.

Senator KASSEBAUM. Well, I think most people would not mind the size of the plane if indeed they were getting a fare that was proportionate to what you can drive for.

Mr. KRUEGER. I have nothing personally against small planes, but I got a little concerned last summer when I flew to Lebanon, N.H. up to Dartmouth College, and I walked up to the counter of this little commuter airline and they asked me how much I weighed. It depended upon which side of the plane I sat on.

Senator KASSEBAUM. Well, that has happened to me, too.

Mr. KRUEGER. You weigh a lot less than I do, ma'am.

Senator KASSEBAUM. I very much appreciate your testimony. And let me praise the work of the GAO, because I think it is a valuable service to us in helping us analyze particular situations, and we very much appreciate your comments.

Mr. KRUEGER. Thank you.

[The statement follows:]

STATEMENT OF OLIVER W. KRUEGER, ASSOCIATE DIRECTOR, RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION

Madam Chairman and Members of the Subcommittee: We welcome the opportunity to discuss our draft report entitled "The Changing Airline Industry: A Status Report Through 1982."

The airline industry is changing, responding to greater freedoms provided by the Airline Deregulation Act of 1978. Our current report is the fourth in a series of reports on airline industry operations, and is intended to take a snapshot of the airline industry before and after the act's passage. It compares traffic trends; fares; profits; productivity; service patterns, particularly at small communities; and air safety before and after deregulation.

In 1982, air fares fell below 1981 levels, while airline costs rose slightly. In addition, air traffic, weekly departures, available seats, and load factors all turned upward. The airline industry suffered losses last year, as return on investment fell to a 7-year low. Certificated and commuter airlines lowered their overall accident rate in 1982, but fatalities were up over the prior year's level.

Five years of experience with deregulation

The airline industry, which is sensitive to general economic conditions, was adversely affected in 1982 by a third consecutive year of recession. In the first 2 years

after deregulation, 1978 and 1979, economic indicators were rising and the airline industry experienced moderate airfare increases, substantial air passenger travel growth and broad based gains in departures, available seats, and flight frequencies compared with the years before deregulation. In the next two years, 1980 and 1981, the airline industry was buffeted by the combined effects of recessions, rapidly rising fuel costs, and the air traffic controllers strike, all of which led to an erosion of the first two years' gains. In 1982 the economy was in a third year of recession and airlines profitability continued to decline. Information reported by the airlines for the first 3 months of calendar year 1983 shows air traffic is increasing but airline profitability is still declining.

Traffic trends

Since deregulation began, airline traffic in terms of revenue passenger miles and total passengers increased substantially. In the first 2 years of deregulation, 1978 and 1979, the number of passengers increased by an average of about 30 million per year; the next 2 years saw passenger decreases of 18.5 million in 1980 and 7.6 million in 1981; during 1982 passengers increased by 12.4 million. The average annual increase in passengers since deregulation was 9.3 million, while the annual increase in the five years before deregulation was 11.5 million. Chart 1, at the end of this statement, illustrates this.

Fares and costs

During the past 11 years, air fares and airline costs have risen significantly, as shown in table 1. In the period 1972–77, which was before deregulation, air fares per passenger-mile rose by 33 percent. During the same period, airline costs rose by 72 percent.

In the 5-year period after deregulation began, average fares per passenger-mile increased by 46 percent, while airline costs rose by 87 percent. In 1982, air fares fell 6 percent below prior year levels while airline costs rose 2 percent.

Return on investment

The domestic airline industry's rate of return on investment fell to a 7-year low in 1982. By contrast, the industry had a decade-high rate of return on investment in 1978 and an above-average return in 1979. In 1982 one of the industry's major airlines, Braniff and two other smaller airlines declared bankruptcy. Table 2 provides more detail.

Productivity

Improved airline productivity and favorable economic conditions were two major factors that contributed to airline profitability in 1978 and 1979. The Nation's recession and inflation adversely affected the industry's profitability in the next 2 years and led to lower airline productivity, as evidenced by lower load factors and higher airline costs. In 1982, despite a third year of recession, airline productivity improved. Part of the gains, however, resulted from price discounting which although increasing passengers and load factors, did not improve the airlines' profitability.

Load factors

During 1982 airlines were able to increase the percentage of available seats sold. As chart 2 indicates, the 1982 load factor of 58.5 percent, while still above the average load factor of 55 percent for the 4 years before deregulation, fell below the load factors experienced in 1978 and 1979. A traffic boom in 1978 and 1979 allowed airlines to increase their load factors to 61 and 63 percent, respectively. In 1980 and 1981, available seat-miles increased, while revenue passenger-miles declined, dropping the load factor to 58 and 57.5 percent, respectively. With airlines making increasing use of discount fares, load factors rose slightly in 1982.

Air service patterns

Since deregulation, weekly departures and available seats have increased at all but the smallest communities. The growth in air service is marked by sharp gains from 1977 through 1979, broad/based declines from 1979 through 1981, and renewed gains in 1982. Additional detail is provided in table 3.

Small community service

Communities of all sizes benefited from the renewed gains during 1982. Since deregulation, however, only the smallest communities have suffered declines in departures and available seats. Significant gains in service at these communities initially

occurred between 1977 and 1979, and were followed by severe declines in service during 1980 and 1981 and renewed gains in 1982.

Statewide service

Changes in air service patterns have not affected all geographic areas equally. Twenty-seven States had increases in weekly departures and available seats between 1977 and 1982. The remaining 21 of the contiguous 48 States and the District of Columbia had a decrease in departures and/or available seats.

Service terminations

During the 10 years before the act was passed, 137 communities lost all certificated air service—service provided by airlines holding Civil Aeronautics Board certificates of public convenience and necessity. As of December 1982, CAB was subsidizing air service to three of these communities and 14 others were receiving unsubsidized air service. The Airline Deregulation Act guaranteed essential air transportation for 10 years to small communities that were receiving air service on the date of the act from a certificated carrier. We recently issued a report on this program ("More Flexible Eligibility Criteria Could Enhance The Small Communities Essential Air Service Subsidy Program," GAO/RCED 83-97, May 18, 1983). In that report, we suggested that Congress consider changes to the program to allow CAB, which administers the program, to help some communities develop markets using higher subsidies or discontinue subsidies to communities unlikely to support air service. CAB has determined the essential air service requirements and has ensured continued air service to 555 small communities that were covered by this provision. Of the 203 small communities that were receiving service on the date of the act from noncertificated carriers, and were, therefore, not eligible for essential air service protection, 102 communities or 50 percent lost all air service since deregulation.

Deregulation and air safety

According to studies by the Secretary of Transportation, there was no evidence that deregulation had adversely affected air safety in 1979, 1980, or 1981. The fourth report, which will cover 1982, has not yet been issued as of May 17, 1983, but air traffic safety statistics for 1982 indicated that certificated airlines lowered their overall accident rate. However, two major fatal accidents—a January 1982 Air Florida crash in Washington, D.C., claiming 78 fatalities, and a July 1982 Pan Am crash in Kenner, Louisiana, claiming 153 fatalities—raised the 1982 fatality rate significantly above that of 1981. Commuter airlines cut their fatal accident rate and fatality rate by about one-half in 1982 compared with 1981. There have been no major fatal accidents to date in 1983.

Mr. Chairman, this concludes my statement. We will be pleased to respond to your questions.

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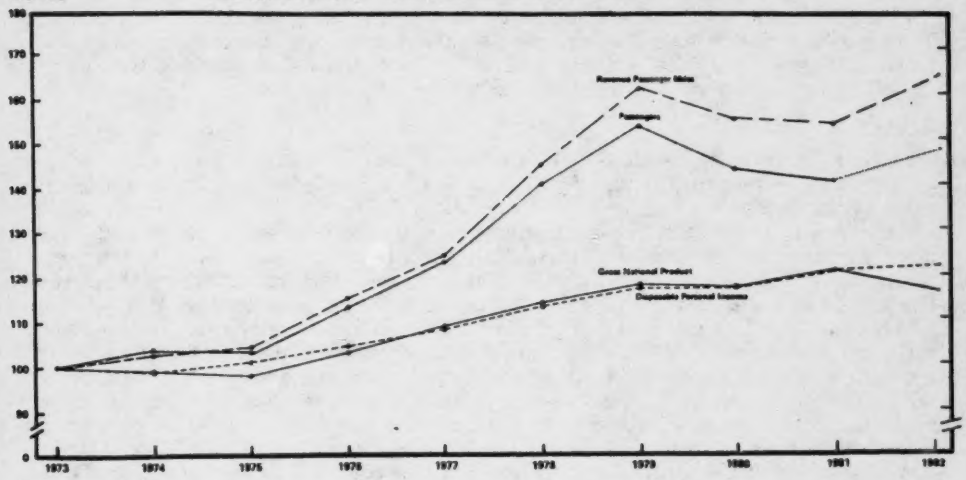
Chart 1

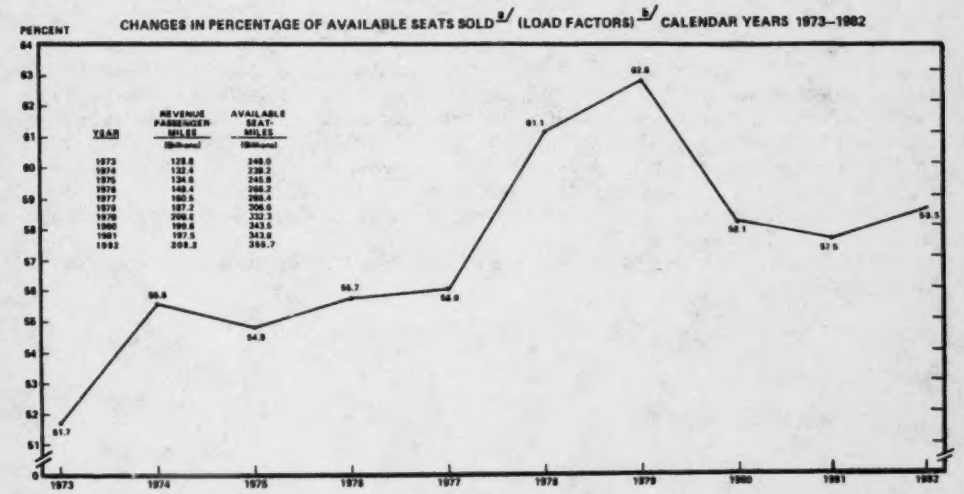
CHANGES IN TRAFFIC [a] AND ECONOMIC INDICATORS CALENDAR YEARS 1973– 1982



[a] Carries domestic scheduled certificated carriers, former intrastate carriers, and commuters.

Chart 2

CHANGES IN PERCENTAGE OF AVAILABLE SEATS SOLD [a] (LOAD FACTORS) [b] CALENDAR YEARS 1973–1982



[a] Carries domestic scheduled certificated carriers and former intrastate carriers. Data are not available for domestic commuters.

[b] Revenue passenger miles divided by available seat miles.

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TABLE 1.—CHANGES IN CONSUMER AND AIRLINE COSTS

[In percent]

	Before deregulation (1972–77)		After deregulation (1978–82)	
	Total increase	Average annual compounded increase	Total increase	Average annual compounded increase
Air fares	33.3	5.9	46.4	7.9
Airline costs index [1]	72.2	11.5	87.4	13.4
Consumer Price Index	44.9	7.7	59.2	9.7

[1] Based on a CAB index of costs to the airline—fuel, personnel, goods and services purchased, and landing fees, but not capital charges such as depreciation, amortization, and interest. This index compares prices paid by the airlines in a given period to prices paid in 1978.

TABLE 2.—*Rate of return on investment [1] domestic operations*

Year:	*Percent*
1982	3.3
1981	[2] 4.3
1980	[3] 5.6
1979	7.1
1978	12.9
1977	9.7
1976	7.9
1975	3.2
1974	9.0
1973	6.3
1972	6.1
1978–82 average	6.6
1972–77 average	7.0
1972–82 average	6.9

[1] Based on CAB definition of airline rate of return. Basically, the figure represents net income and interest expense divided by the sum of airline debt and equity.

[2] Excludes Pan American World Airways' extraordinary gain of $249.4 million on the sale of Intercontinental Hotel in 1981. If the extraordinary gain is included, the 1981 return on investment is 6 percent. The 1972–82 average is 7.2 percent if both the 1980 and 1981 extraordinary gains are included.

[3] Excludes Pan American World Airways' extraordiary gain of $294 million on the sale of the Pan Am Building in 1980. If the extraordinary gain is included, the 1980 return on investment is 7.8 percent.

TABLE 3.—SUMMARY OF WEEKLY AIRCRAFT DEPARTURES AND AVAILABLE SEATS BY HUB CATEGORY

	Hub market				
	Large	Medium	Small	Nonhub	Total
Number of communities	23	35	62	518	638
Number of departures per week (in thousands):					
October 1, 1977	58.6	21.7	12.8	27.4	120.6
October 1, 1978	61.9	23.4	13.7	29.6	128.6
October 1, 1979	66.8	25.3	14.5	31.2	137.8
October 1, 1980	63.4	22.8	13.3	27.8	127.3
October 1, 1981	61.5	22.8	12.4	25.9	122.7
October 1, 1982	65.8	26.7	14.5	26.9	133.8
Percentage change:					
1977–82	12.2	22.9	12.7	−2.0	11.0
1977–79	13.9	16.6	13.0	13.9	14.3
1978–82	6.2	14.1	5.8	−9.1	4.1
1979–82	1.5	5.4	−0.2	−13.9	−2.9
1980–81	−2.9	0.1	−7.1	−7.0	−3.7
1981–82	6.9	16.8	16.8	3.9	9.1

TABLE 3.—SUMMARY OF WEEKLY AIRCRAFT DEPARTURES AND AVAILABLE SEATS BY HUB CATEGORY—Continued

	Hub market				
	Large	Medium	Small	Nonhub	Total
Number of available seats per week (in millions):					
October 1, 1977	6.6	2.2	1.1	1.1	11.0
October 1, 1978	7.0	2.3	1.2	1.1	11.6
October 1, 1979	7.6	2.3	1.2	1.1	12.1
October 1, 1980	7.1	2.1	1.1	1.0	11.3
October 1, 1981	7.0	2.1	1.0	0.8	11.0
October 1, 1982	7.7	2.5	1.1	0.9	12.3
Percentage change:					
1977–82	16.4	15.3	2.9	−16.8	11.6
1977–79	13.9	8.5	4.4	0.5	10.6
1978–82	10.2	9.3	−2.7	−18.8	6.0
1979–82	2.2	6.3	−1.5	−17.2	0.9
1980–81	−1.4	2.1	−8.3	−13.6	−2.5
1981–82	9.8	17.8	13.8	7.7	11.6

Note: Totals may not add due to rounding.

Senator KASSEBAUM: Thank you.

[Whereupon, at 12:10 p.m., the hearing was recessed, subject to the call of the Chair.]

AIRLINE DEREGULATION ACT OF 1978

TUESDAY, JUNE 28, 1983

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON AVIATION,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:40 a.m., in room SR-253, Russell Senate Office Building, Hon. Nancy L. Kassebaum (chairman of the subcommittee) presiding.

Senator KASSEBAUM. The hearing will please come to order. I believe we will go ahead with the first panel although Mr. Armellino is not here but, Mr. Taneja, if you will, please.

Senator Exon has to go back and forth to Armed Services markup so he has a few comments that he would like to make before we start out because he cannot be here for the whole hearing.

OPENING STATEMENT BY SENATOR EXON

Senator EXON. Thank you very much, Madam Chairman, and thank you especially for holding these oversight hearings, which I think are tremendously important, especially to certain sections of our Nation. This is the second day of the Aviation Subcommittee's hearings on airline deregulation.

Airline deregulation has been the subject of much debate by several Members of the Senate in recent months, as well as by many in the industry and certainly those who watch it very closely. I am looking forward to today's witnesses, who will hopefully provide us with some insight on how the aviation community has addressed the problems caused by deregulation, and we all know that there have been many, as well as to discuss what should be done to better improve upon the situation that presently confronts us.

I support airline deregulation and am fully aware that we cannot return to total regulation. However, the need for an air transport system that serves all the people, adequately, is of paramount importance to this particular Senator.

I will not stand by watching as service is reduced in many smaller and medium-sized communities across the country. For this reason I am eager to hear our witnesses today as they discuss not only airline operations but also the difficulties they have encountered in trying to preserve small community service.

I want to commend my colleague from Kansas, Senator Kassebaum, for calling these timely hearings, and I am happy to join her today in meeting with each of you, the witnesses who we depend

upon to give us some insight and input as to what we should and should not do in the Nation's Capital.

Thank you, Madam Chairman.

Senator KASSEBAUM. Thank you very much, Senator Exon.

Mr. Taneja, of the flight transportation laboratory, department of aeronautics and astronautics, Massachusetts Institute of Technology, it is a pleasure to welcome you here with what we hope will be some insightful observations in this particular area of concern.

STATEMENT OF NAWAL K. TANEJA, FLIGHT TRANSPORTATION LABORATORY, DEPARTMENT OF AERONAUTICS AND ASTRONAUTICS, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Mr. TANEJA. Thank you.

Senator Kassebaum and members of the subcommittee, I am appearing here on my behalf today. I have been on the faculty at MIT for 12 years and since 1980 have also been the president of Flight Transportation Associates, an international aviation consulting firm with offices in Cambridge, Mass.

I appreciate sincerely this opportunity to appear before you to discuss vital issues in airline deregulation which I have followed very closely in my research, teaching, and consultations in the airline industry. I have written several books on the airline industry and am at present writing one which is completely devoted to this particular subject.

In the mid-1970's regulatory reforms were discussed as ways to increase efficiency and productivity in the airline industry, which would in turn lead to more efficient price/service options for the consumer. However, I still fail to see how we moved from regulatory reforms to total deregulation.

Be that as it may, the Airline Deregulation Act of 1978 was passed. We now have about 4½ years of experience. Can deregulation of the domestic airline industry be considered a success? The answer unfortunately is both yes and no. The dilemma exists because of at least five factors.

First, in addition to deregulation, other events occurring during the last 5 years have complicated a precise assessment of the net benefits of deregulation. These events include the long recession, fuel price increases followed by decreases, the DC10 grounding, and the PATCO strike. It is impossible to separate out precisely the impact of each and every factor.

No. 2, while certain segments of the traveling public have clearly benefited from lower fares, other segments have not benefited or in fact are paying a substantial increase in fares. My examination of actual average yields in over 24,000 markets between the fourth quarter of 1978 and the second quarter of 1982 shows that the highest decrease in real yields was observed in markets between 2,000 and 3,000 miles in length of haul and density over 1,100 passengers a day.

The highest increase, on the other hand, was observed in markets less than 1,000 miles in length of haul and density of less than 110 passengers per day. These data show that while the greatest benefit of lower fares went to passengers traveling in five long-haul

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high density markets representing 2.9 percent of the passengers, the largest increase in fares was experienced in almost 14,000 markets representing 17.4 percent of the passengers.

No. 3, the profitable growth of some of our smaller major carriers and nationals is not necessarily the result of any inherent efficiency relative to our major carriers. Instead, their fleets simply turned out to be better suited to the new environment than the majors.

No. 4, while services to some small communities have increased, services to other communities have decreased either in quantity or quality or both. And yet despite this reduction in the quantity or quality of service offered or both, the fares paid by consumers travelling in and out of small communities have increased at a rate more than twice the systemwide average rate of increase.

No. 5, the 12 major carriers have lost almost $4 billion in operating losses and interest since 1979. These losses are staggering by any other industry standard and they are worrisome. During the first quarter of 1983 the losses experienced by the industry were the highest ever in any first quarter.

These losses, Senator Kassebaum, exist despite an increase in traffic, a decrease in fuel prices, a decrease in interest rates, a decrease in inflation rate, and an increase in airline efficiency and productivity.

Senator, I worry when Delta, a very efficient airline by any standard, posts the third largest operating loss of all the majors in the first quarter.

The existence of these factors makes it difficult to assess the precise impact of deregulation. However, in my opinion it is totally unreasonable to say what the proponents of deregulation claim, that all that is good in this industry is due to deregulation and all that is negative is due to other factors.

Will the inequities in the consumer fares and the financial losses of the industry continue in the long run? In my opinion, yes. In the written testimony I provide at least eight reasons why irrational pricing behavior could continue. These eight factors, if not individually then at least collectively, indicate that the marketplace alone is not sufficient to, No. 1, insure that the entire population has the opportunity to purchase equitable fares with reasonable access to the Nation's air transportation system; and No. 2, to protect this vital industry from self-destruction.

These two requirements cannot be met if the fare structure is less than rational. Now if total regulation is ineffective and if total deregulation is ineffective, the answer, it appears to me, is a minimum involvement by the Government to moderate the operation of the free marketplace.

I digress for a little bit to answer a very interesting question. When the major airline industry is losing so much money and the majority of the carriers have identified excessive competition as a major cause of deterioration in yield, why are many airlines, particularly the majors, still in favor of total deregulation? In my opinion there are at least four parts to this answer.

Managements of several major established airlines have been criticized for being unable to compete in the totally deregulated environment.

Some of these airline managers consider these criticisms to be a challenge to be proved wrong, and they do not wish the rules of the game to be changed despite the fact that their companies, their employees, and their stockholders' equity may be at stake.

No. 2, most majors have now made a serious commitment to adjust route structures and resources to compete more effectively in the free marketplace.

No. 3, even though some managers view fare guidelines as desirable, they seem to think that they cannot have fare control without route control.

No. 4, the senior executives at major airlines, I presume, expect that a shakeout will soon take place, and each carrier feels that its chance of survival is better than the others.

These positions, in my opinion, are short-term considerations.

The Government, on the other hand, must not only focus on much broader issues but consider longer-term impact of deregulation as well. In this context it is clear that the Airline Deregulation Act of 1978 must be adjusted to implement features that increase efficiency and productivity, promote long-term stability and provide cost-effective choices for all consumers.

These objectives can be achieved by imposing a flexible but a carefully designed distance-based structure, a fare structure, that is, which relates fares across all markets. I do believe its implementation would protect the consumer and the industry. For consumers, fares would become more equitable. For airlines, the probability of predatory pricing would decrease and cost-oriented fare structures would increase.

In conclusion, while I do not recommend, I repeat I do not recommend that the industry be reregulated in the pre-1978 format, I do believe some guidelines are necessary. With reasonable guidelines the benefits of competition can be preserved and the adverse effects of cutthroat fare wars avoided to everyone's advantage.

Thank you.

[The statement follows:]

STATEMENT OF NAWAL K. TANEJA, FLIGHT TRANSPORTATION LABORATORY, DEPARTMENT OF AERONAUTICS AND ASTRONAUTICS, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Senator Kassebaum and members of the subcommittee, my name is Nawal K. Taneja and I am appearing here on my own behalf. I have been on the faculty of the Massachusetts Institute of Technology in the Department of Aeronautics during the last twelve years, and since 1980 have also been the President of Flight Transportation Associates, an international aviation consulting firm with offices in Cambridge, Massachusetts. I appreciate this opportunity to appear here today to discuss vital issues in airline deregulation, which I have followed closely in my research, teaching, and consultations. I have written several books on the airline industry and am, at present, writing another book devoted entirely to the area under consideration today.

1. BACKGROUND

During the seventies, the economic justification for regulation of industries in the United States began to lose its appeals, as inefficiencies in several regulated industries came to light in the press and in the economic literature. In the case of the airline industry, Congress held a number of hearings to determine what the effects of regulation on airline economic performance would be, whether or not the existing regulatory regime should continue, or whether there should be any changes in the statutory framework.

The majority view held that since the environment had changed sufficiently, it was no longer necessary for the CAB to regulate the industry. In fact, it was urgued that continued regulation would prevent the industry from increasing efficiency and productivity. Consequently, it was generally agreed that some form of regulatory reform was warranted to promote greater price competition. However, it was also argued that effective price competition could not take place without freedom of entry and exit. Attention therefore turned away from regulatory reform and towards total deregulation. The end result was the passage of the Airline Deregulation Act of 1978.

2. RECENT INDUSTRY EVENTS

We now have about four and one half years of experience, each year with less and less regulation. Can deregulation of the domestic airline industry be considered a success? The answer, unfortunately, is both yes and no. The dilemma exists because of at least five factors which we can now discuss.

(1) In addition to deregulation, other events that have occurred during the last five years have complicated the precise assessment of the net benefits of airline deregulation. These other events include a long recession, fuel price increases followed by decreases, the DC–10 grounding, and the PATCO strike. For example, are fare wars the result of overcapacity or deregulation? And did the allocation of airport slots, resulting from the PATCO strike, prod some airline managers into leaving more capacity in a market than was warranted to protect slots, *or* did it stop them from adding more capacity to a market that could sustain it? It is impossible to separate out precisely the impact of each and every factor.

(2) While certain segments of the traveling public have clearly benefitted from lower fares, other segments have not benefitted and are in fact paying a substantial increase in fares. Table 1 shows the increase in average real yield (between Fourth Quarter 1978 and Second Quarter 1982) for 24,054 markets disaggregated by distance and passenger density. The highest decrease in real yields was observed in markets of between 2,000 and 3,000 miles length of haul and density of over 1,100 passengers per day, both ways. The highest increase in real yield, on the other hand, was observed in markets of less than 1,000 miles length of haul and density of less than 111 passengers per day, both ways.

Table 2 shows the number of markets, out of the 24,054 market sample, that were in various cells, classified by distance and traffic density. Assuming the change in average yield is not an unreasonable measure of the change in average fare, these data show that while the greatest benefit of lower fares went to passengers traveling in five high-density long-haul markets (representing 2.9 percent of passengers), the largest increase in fares was experienced in 13,759 markets (representing 17.4 percent of passengers) that are short and medium haul in length and low and medium density.

Under deregulation, and according to its principles, inequities in fares, similar to those existing between interstate and intrastate markets, should have diminished over time. Instead, after four and one half years, disparities in fares for comparable services provided have increased and in many cases, increased substantially.

(3) The profitable growth of some of the smaller major carriers such as USAir and nationals such as Ozark is not necessarily the result of any inherent efficiency among these carriers relative to the major established carriers such as United and Eastern. Instead, their fleets turned out to be better sited to the new environment than the majors. Over the years, the larger carriers had acquired large aircraft appropriate to routes granted by the CAB under the regulated regime. The larger aircraft could not be used to complete in markets served by the smaller airlines. Many of these markets were ripe for additional service which the larger carriers couldn't provide. The smaller airlines, on the other hand, acquired aircraft of the correct size; this allowed them not only to move into markets not fully served but to enter markets where the larger carriers could not mount a strong competitive reaction.

It should be kept in mind that the smaller airlines do not now own the appropriate size fleets because of any great foresight. Instead, they acquired smaller aircraft for two other reasons, both beyond their control: (1) the route structure restrictions dictated by the CAB under the regulated regime, and (2) the fuel price increases, which showed that the smaller, two-engined aircraft were more cost-effective once the price of fuel went up.

(4) While service to some small communities has increased, service to other communities has decreased, either in quantity or quality or both. Table 3 shows the changes in service in and out of over 300 Essential Air Service points, for example, points enplaning fewer than 40 passengers per day.

Small community service analysis shows that the significant increase in the number of departures is offset by the decrease in number of seats, due to the substitution of small aircraft in these markets. So there is continuing debate on whether the quantity or service has increased or decreased.

In any case, the quality of service offered has deteriorated. Taking the number of destinations receiving nonstop service and the number of points receiving single-plane service from the EAS points as two proxies for measuring quality of service, quality of service has gone down by both measures. Yet despite the reduction in the quality of service offered, the fares paid by consumers traveling in and out of small communities have increased at a rate more than twice the system-wide average rate of increase.

(5) The airlines in general are pleased with the new freedom to enter and exit a market, but the 12 major carriers have lost almost $4 billion (in operating losses and interest) since 1979 in domestic operations alone. By other industry standards during the same period, these losses appear not only worrisome but staggering. United's losses alone (operating loss and interest) amount to $970 million during the four years—this averages out to a loss of $664,000 every single day for the last four years. During First Quarter 1983, even the traditionally profitable carriers (such as Delta and Northwest) lost money. Delta, for example, posted the third largest operating loss of all the majors. United and TWA were first and second, both with operating losses in excess of $100 million.

The 16 nationals who showed an operating profit of $496 million on domestic operations for these four years still incurred a loss of $249 million after interest payments. And again, this group includes profitable carriers such as Piedmont and Southwest.

The existence of these factors makes it difficult to assess the precise impact of deregulation. It is therefore also unreasonable for the proponents of deregulation to claim that all that is good in the industry is the result of deregulation, while all that is negative is due to other external factors. For example, proponents claim that (1) deregulation is working; (2) all beneficial impacts of the last few years (such as lower fares, higher service, and constraints on labor costs) are due to deregulation; but (3) all detrimental impacts (such as higher fares and lower service in some markets, enormous industry losses, employee reductions, and carrier bankruptcies) are due to factors other than deregulations (the "other" factors cited always include recession, fuel increases, and the PATCO strike).

The recent report by the CAB staff entitled "Competition and the Airlines: An Evaluation of Deregulation" [1] is an example of the "pro-deregulation" study. It is a large-scale report—and the only report of its type that is currently available—by a respected agency. However, it is not complete enough to vindicate the conclusions derived by some deregulation proponents. There were no sections included, for example on the financial losses of the industry or the carriers that had to declare bankruptcy. Not only did a major carrier and a number of small carriers go out of business, but the reductions in labor force among the remaining carriers must be considered equivalent to the loss of at least another major carrier. The only reasonable conclusion that can be drawn about deregulation must be drawn from the experience of the past four years, rather than from this study. That conclusion is that the deregulation of the industry has produced both beneficial and detrimental impacts.

3. OBSERVED INDUSTRY BEHAVIOR SINCE DEREGULATION

Everyone recognized that there would be winners and losers in the short term. But the long-term impact is the problem that the Congress faces today. Looking at past experience, the question that remains is a pressing one; what will the long-term impact be if the industry is left to the forces of the marketplace only? We can suppose some answers by taking a hard look at the marketplace since 1978.

One observed outcome is that prices in the ariline marketplace have seldom been dictated by the cost of operations; in many cases, they have been dictated by other needs of carriers. The $39 fare from Detroit to New York and the $99 Anywhere fare were just two examples of fares that had no relationship to costs. Pan American offered the $99 fare not because it became more efficient and its costs declined, but because if needed to improve its cash flow and on-line feed from domestic to international operations. Sicne most carriers consider it necessary to match the

[1] David R. Graham and Daniel P. Kaplan. "Competition and the Airlines: An Evaluation of Deregulation," Staff Report, Office of Economic Analysis, Civil Aeronautics Board, December 1982.

lowest fare in a market, two things happen: (1) many passengers wind up paying unreasonable fares, and (2) the industry as a whole suffers. The matching fares policy is based on the premise that the services offered by different competitors in a single market cannot be easily differentiated.

Another outcome is the apparent success of new airlines. A close look at the new airlines shows their gains in the marketplace resulting from three basic factors: (1) the new carrier costs are lower at the present time due to a more intensive use of the labor force, simplicity of operations, contracting out arrangements for particular functions, and the opportunity to use second-hand aircraft whose prices declined as a result of overcapacity; (2) the new carriers have offered low-price service, mostly in the high-density markets; and (3) the new carriers have offered different standards of services on the ground (e.g., additional payment for checked baggage) and amenities in the cabin. However, the operating costs of the newly established carriers could increase significantly in the near future. They are subject to any number of factors, including growth and maturity, lack of availability of used aircraft, increase in the price of fuel which would lessen the cost-effectiveness of second-hand aircraft, and a decision by the established carriers not to perform certain contract work.

The evidence available to date gives no reason to believe that the natural forces of the marketplace will lead the industry to cover its costs sufficiently. These costs cannot be recouped adequately in the long run for the following reasons, some of them peculiar to the airline industry:

(1) Lack of ability to produce a real and long-lasting product differentiation, which cancels out some of the natural operations of the marketplace that would otherwise be in effect.

(2) Ability of an airline to justify almost any fare, within a broad range, given airline inability to determine costs for individual flight segments in a nonarbitrary manner.

(3) Absence of effective channels to investigate and, if necessary, prosecute predatory competitive behavior.

(4) Use of short-term marginal cost pricing and other promotional fares by both new and established carriers to fulfill certain short-term needs.

(5) The nature of the aircraft, an extremely and unusually mobile asset (unlike a factory) which can be used easily to enter into and exit from a market. Thus, either a new or established carrier going into another carrier's market could use marginal cost pricing to gain market share. The mobile asset characteristic could also be used to skim the cream in a market.

(6) Ease of entry into the industry relative to exit from the industry, given the influence of external forces such as the financial community. A number of airlines now in business are so weak financially that they would not be able to stay in business were they in another industry.

(7) Overcapacity, which is partly the result of the industry's inherent inflexibility. A carrier with, say, 10 percent overcapacity cannot remove 10 percent of the seats from each aircraft. It is no more reasonable to make random reductions in frequency in markets served.

(8) A carrier experiencing little or no growth relative to its competitors can try to expand its market share by increasing its sales and commissions. In the long run, such a strategy would damage the industry as a whole.

These eight factors, taken one at a time, may not be enough to prove that the airline industry is so unique that it requires comprehensive government regulation. Taken together, however, the eight factors clearly impede the natural operation of the marketplace on this industry. Keeping in mind the purposes of deregulation, these factors, at least collectively, indicate that the marketplace alone is not sufficient to: (1) ensure that the entire population has the opportunity to purchase equitable fares with reasonable access to the nation's air transportation system; and (2) protect this vital industry from self destruction. And these two requirements cannot be met if the fare structure is less than rational. Indeed, the recent experience of the industry under total deregulation shows that the natural forces of the marketplace are not sufficient to guarantee a rational fare structure. On the other hand, it was argued in the regulatory reform discussions that total regulation of the industry does not lead to the optimal results either. It appears to me that the answer is a minimum involvement by the government to moderate the operation of the free marketplace.

Now that it is apparent that the airlines as a group have experienced enormous losses in the last four years, and given that the majority of carriers have identified excessive competition as a major cause of deterioration in yield, a very interesting question arises: why are the majority of the airlines, particularly the majors, still in

favor of total deregulation? In my opinion, the following four points provide some insight into the answer.

(1) The management of several major established airlines adhere to deeply held values and long entrenched business practices, for which they have been criticized. These include notions, for example, that bigger is better and that market share is the name of the game. Critics claim these practices are responsible for airline inability to compete profitably in the free marketplace. Some airline managers consider these criticisms a challenge to be proved wrong and do not want the rules of the game to be changed, despite the fact that their companies, their employees, and their stockholders' equity may be at stake.

(2) Most majors have now made serious commitments to adjust route structures and resources to compete more effectively in the free marketplace. The commitment shows up in further development of the hubs and orders for the smaller, more fuel-efficient aircraft. The hub strategy enables a carrier to increase on-line feed; it also increases the difficulty for competitors trying to break in. The trend toward smaller aircraft would allow the majors to retaliate more effectively against the smaller majors and the nationals.

(3) Even though some senior managers view fare guidelines as desirable, they seem to think that it is not realistic to control fares without any controls on route entry and exit. As most managers value entry and exit freedom, then, presumably, they accept total deregulation, since they think that they cannot have fare control without route control.

(4) The senior executives at several major airlines, I presume, expect that a shakeout is in the offing. However, each carrier feels that its chances of survival are better than the others. Consequently, after the shakeout, the remaining carriers would be better off in the deregulated environment, and the sooner the better. Until then, according to these executives, it is better to maintain total deregulation.

The major airlines still account for 73.2 percent of the total passengers transported and 83.2 percent of the revenue passengers miles flown. The positions they take, in my opinion, reflect narrow, short-term considerations. The Congress, on the other hand, must not only focus on much broader issues but consider the longer-term impact of deregulation as well. In this context, it is clear that the Airline Deregulation Act of 1978 must be adjusted to implement features that increase efficiency and productivity and, more important, promote long-term stability.

4. THE NEED FOR POSITIVE ADJUSTMENTS

The goals of any modification of policy at this point in time are: (1) to prevent inequitable price offerings to consumers in markets where there is not much price competition; (2) to provide consumers with full knowledge of prices in advance of travel to allow them to select with confidence; and (3) to promote efficiency as well as long-term stability in this industry. These objectives can be achieved.

By way of example, I offer the following possibility. It represents a minimal government involvement in the airline industry. It also preserves the desirable attributes of carrier competition, at the same time protecting the consumer as intended under deregulation. That is, to impose a distance-based structure (similar to the one proposed by American Airlines recently) which relates fares across all markets. While the structure of fares would thus be controlled, the level of fares would remain competitive. However, without some government involvement, it is doubtful that a rational fare structure (one that meets the needs of the consumer and the industry) could be maintained by the industry on its own, given the existence at any one time of one or more of the eight factors discussed in the previous section.

I do not intend this preliminary suggestion to be either dogmatic or inflexible. Nevertheless, I do believe that its implementation would protect the consumer and the industry. For consumers, fares would become more equitable; for airlines, the probability of predatory pricing would decrease, and cost-oriented, if not cost-based, fares structures would increase.

In conclusion, while I do not recommend that the industry be re-regulated in the pre-1978 format, I believe some guidelines are necessary. With reasonable guidelines, the benefits of competition can be preserved and the adverse effects of cut-throat fare wars avoided, to everyone's advantage.

Thank you.

TABLE 1.—PERCENT CHANGE IN AVERAGE RAL YIELD IN DIFFERENT MARKET GROUPS

[Fourth quarter 1978 to second quarter 1982]

Distance (miles)	Traffic density (passengers per day—both ways)					Subtotal (percent)
	0 to 11	12 to 55	56 to 111	112 to 1111	1112+	
0 to 500	35.0	26.3	22.4	1.8	(13.4)	2.2
500 to 1,000	31.2	23.2	18.1	7.9	(3.7)	11.9
1,000 to 1,500	12.0	1.3	(3.5)	(3.4)	(10.4)	(2.5)
1,500 to 2,000	6.3	(3.2)	(5.1)	(4.6)	10.0	(1.5)
2,000 to 2,500	4.4	(9.0)	(9.4)	(15.3)	(27.0)	(15.8)
2,500 to 3,000	(12.9)	(17.2)	(14.6)	(17.8)	(30.6)	(21.3)
3000+	6.9	(2.0)	0.2	(9.4)	—	(5.3)
Subtotal	15.7	6.3	4.9	(4.4)	(17.5)	(1.3)

Source: CAB origin and destination survey data.

TABLE 2.—NUMBER OF MARKETS

[Second quarter of 1982]

Distance (miles)	Traffic density (passengers per day—both ways)					Subtotal (markets)
	0 to 11	12 to 55	56 to 111	112 to 1,111	1,112 +	
0 to 500	4,192	530	151	255	25	5,153
500 to 1,000	7,863	703	140	247	8	8,961
1,000 to 1,500	4,572	391	72	118	6	5,159
1,500 to 2,000	2,267	197	41	57	3	2,565
2,000 to 2,500	1,177	125	27	41	2	1,372
2,500 to 3,000	409	42	15	16	3	485
3,000 +	321	28	5	5	.....	359
Subtotal	20,801	2,016	451	739	47	24,054

Source: Cab origin and destination survey data.

TABLE 3.—CHANGES IN THE QUANTITY AND QUALITY OF SERVICE FROM ESSENTIAL AIR SERVICE CITIES

	January 1979	January 1983	Percent change
No. of departures	98,722	123,110	24.7
No. of seats	4,289,620	3,832,245	(10.7)
No. of destinations with nonstop service	1,257	1,188	(5.5)
No. of destinations with single-plane service	1,512	1,322	(12.6)

Source: Official Airline Guide.

Senator KASSEBAUM. Thank you very much for your very interesting comments.

Before we go to questions, has Mr. Armellino come in?

[No response.]

Senator KASSEBAUM. All right. Then we will direct all our questions to you at this point.

I wonder if, in your study of this subject, have you done any work on to what degree the fares in low density markets exceed cost plus a reasonable rate of return, and if they do not exceed this figure, how can those rates be any different if we were to return to regulation? Have you taken any look at figures like that?

Mr. TANEJA. Senator, it is relatively easy to make an analysis of airline fares compared to an analysis of airline costs given the fact that a significant portion of airline costs can be allocated in a non-arbitrary manner. Let me give an example.

If Pan American has a flight which goes New York to Los Angeles to Sydney, how much of the total costs are going to be allocated to the New York-Los Angeles portion of that flight? keeping in mind these types of difficulties, some studies have indicated that there is a cross-subsidization which is going on at the present time.

However, I cannot show you the results of any extensive study today other than to answer your question in a slightly different manner. It is true, that it costs an airline more to operate a short haul than it does a long haul segment on a per-mile basis, and therefore fares in the short haul segments should be higher. However, fares in all short haul markets should be higher, not just a few high density markets.

I fail to see why consumers living in high density markets traveling out of New York or Los Angeles to a destination distance of 150 miles, should be offered substantially reduced fares and consumers in and out of smaller cities and traveling the same distance be asked to pay a much higher fare. It is true that some airline costs are also related to traffic density, but I fail to see that the differences are the same as those reflected in airline fares.

Senator KASSEBAUM. So you are assuming that those perhaps traveling in high density markets are below costs?

Mr. TANEJA. In some cases, yes, Senator.

Senator KASSEBAUM. What factors do you think might enter into helping to end the fare war and to establish some certainty in the financial structure?

Mr. TANEJA. Senator, I believe what you need to have is a distance-based fare structure which relates fares to distance in all markets, high density as well as low density, high competition as well as low competition. And if the fare structure is made flexible with appropriate zones of reasonableness around it, then it should be able to accommodate quite adequately the new low cost carriers.

I am not suggesting by any stretch of the imagination that the low-cost carriers should be excluded from the marketplace. Far from it; I think that they have made a significant contribution to our industry. What we need to do is to make the formula flexible enough to be able to include those carriers and their cost efficiencies into the system, but at the same time try to reduce the probability of predatory pricing that could exist.

The $99 fare introduced across the country was not cost related. I have to say that when it was introduced by Pan American it made sense for Pan American. There were only a few flights and these were probably going on to international markets. Pan American could justify the fare based upon its costs. However, the majority of managers in the airline industry feel that the product cannot be differentiated adequately in this industry. Therefore, everyone needed to match the $99 fare. Consequently, what might have been a reasonable fare for Pan American turned out to be unreasonable for the entire industry.

These actions will not stop unless and until there are some guidelines which the industry has to adhere to.

Senator KASSEBAUM. Regarding predatory pricing, it is illegal.

Mr. TANEJA. It is very difficult to prove what is predatory pricing and what is not. The problem, Senator, is when a fare is introduced which is below cost, it would be predatory if it was introduced to eliminate a competitor. But even if it did not eliminate a competitor and as such could not be considered predatory it is still detrimental if it impacts, one, the consumer in terms of inequities; and, two, jeopardizes the financial health of the industry.

Senator KASSEBAUM. Senator Exon has a couple of questions now.

Senator EXON. Thank you very much for your most interesting testimony, and I am going to read through it in its entirety. You put your finger, I think, on some of the concerns of those of us here.

The predatory pricing practices that seem to be going on are condemned generally, but it has been my experience when I talk, as I frequently do, to the leadership in the airline industry they keep telling me how it is all going to work out. They add, however, that it is going to take some time to get this job done.

I am reminded, when I hear that, that Freddie Laker showed us how you can go broke very quickly in the airline industry by pricing yourself out of the market. But some people said, is that not wonderful that Freddie Laker is offering a free ride to Europe?

Well, it is not so wonderful if you are depending upon that kind of service, and certainly those of us who are privileged to live in the less high density population areas have not been served very well thus far by deregulation. I am wondering with regard to—there are so many different angles to this, let me see if I can get your recommendation on one.

Predatory pricing, or let us force the other guy out of business—terminology that is not used very often, but that is what I think it is—is not part of that due to the fact that under deregulation any airline can surprise everyone and announce at any time that they are going to cut their fare from point A to point B in half? Do you think it might give some stability to the marketplace if we could simply say, and have a regulation enforced by the Federal Government, that any airline can change the fares from point A to point B any time they want, but they have to give 30- or 60-day written notice first?

It would seem to me that that might take away some of the attractiveness of an ad that appears in the paper in the morning that says we are going to give you a $99 flight to Hong Kong if you want to go there.

Do you think that if we made the airlines post prices, let them do whatever they want, but require that they post prices so that they can give notice not only to the consuming public, not only to the tourism industry that serves this airline industry so well, but give notice to the competitors as well that we would have made a sound business decision? Likewise, if they want to raise that fare 30 or 60 days thereafter, they have to give that much notice that they are going to raise the fare, for example, from $99 to $399 to go to Hong Kong.

Do you think something like that might at least tend to put some kind of a hold on this predatory pricing, if we can define it?

Mr. TANEJA. Senator, I do not think so, not in the long term. And in order for me to explain my answer, I would like to ask you to give me a few minutes to explain these eight reasons, because they are so fundamental to understanding what makes this industry a little different. I will not use the word unique. As in the case of a public utility.

In this industry, it is very difficult to produce a real and long-lasting product differentiation. A seat is basically a seat. So a carrier would feel impelled to match that fare. Even though he had 30 days to match it, he will still match it.

An airline can justify almost any cost right down to $2, which is the price of the meal, based on the "anyhow" theory that the flight is going to operate anyhow, so carrying an additional passenger is just basically the price of a meal.

No. 3, there is an absence of effective channels to investigate and, if necessary, prosecute predatory pricing, simply because it is difficult to prove.

No. 4, is that the short-term marginal cost pricing and other promotional fares, both by established and new carriers, will continue to exist. We have heard about the short-term cash flow needs of certain carriers.

No. 5, which is very important, an airline is not like a hotel. In the House when I testified, a question was asked: What is the difference between a hotel and an airline?

Well, if a hotel has a problem filling its beds, it cannot take that hotel and place it in another city for 30 days. An airline has a very mobile asset, an aircraft. It can be moved from one city pair to another very quickly. So the temptation to move into somebody else's territory for a short period of time, cream-skim, and leave is great.

No. 6, entry is easy, relative to the exit from the industry. By any financial statistic you care to examine, a number of our major airlines are financially bankrupt. Yet they are still in existence. They would not be in existence if they were in another industry. So there must be some other barriers to exit that are keeping those airlines in operation.

No. 7, overcapacity is partly the result of inherent inflexibility in the industry. If an airline feels that it has 10 percent too many seats, it cannot take out those seats on an aircraft in one market when that aircraft serves a number of markets every day.

No. 8, extremely important, there is a temptation on the part of some airlines to want to increase their market share by increasing the sales and commission rates. It may be of value to them but only in the short term. In the long term, it would be detrimental to the entire industry.

These eight reasons, Senator, at least collectively, provide me with sufficient evidence that rational pricing behavior is hard to envision if left to the free forces of the marketplace.

Senator EXON. As I understand it, now, any airline, Airline A can decide to go into Miami, Fla., or out of Miami, Fla., depending on slot assignments. They could go in there and operate for a week if they wanted to.

It would not be very practical, I suspect, from the standpoint that they have to have personnel there and all these kinds of things, but theoretically, under deregulation in the free enterprise

system, if there were slots available, Airline A could decide to operate out of Miami, Fla., during the months of January and February, which is the main tourist season and theoretically more people are going there. Is that correct?

Mr. TANEJA. That is correct.

Senator EXON. We keep citing the problem. What can we do to cure it or what should we consider, at least, as a possibility?

I am wondering, going back to my earlier question, is there some way that we could still maintain deregulation, except make it more difficult for an airline to come in and out of a market and change fares so abruptly?

That, I would think, would take away at least some of the advantages of predatory pricing or something near to that.

I guess if we could slow down the entry into a market and if we could slow down the raising and lowering of fares, would not that have at least some kind of stabilizing effect?

Mr. TANEJA. There is nothing wrong with the concept of deregulation and it should not be taken away. I suggested that I am not for reregulation.

However, we can keep deregulation and simply introduce some guidelines for implementing fares. Airlines will not be allowed to implement fares below the boundaries of those zones of reasonableness.

If an airline then finds that it cannot introduce an extremely low promotional fare to gain market share in a new market, then that airline would not be tempted to go into, say, Florida just for the month, or 2 months, during the peak period, because it would know that it would have to charge competitive fares with existing airlines and it would be very difficult to gain a market share in that short period of a time.

Senator EXON. I agree with you. So what you are saying is that you believe the Government should come back in. On the one hand, you say you are for deregulation. Then you come back and say yes, but you want the fares controlled.

Really what you are saying, then, is that you are suggesting that we at least consider the possibility of defusing deregulation, at least to the point of having a basic fare rate beyond which no one could go into a certain area. Is that what you are saying?

Mr. TANEJA. That is correct. I am suggesting that we have a well-defined method of putting fares in the marketplace within a zone, which means that if an airline feels that its cost structure is low, or it has certain efficiencies, or it is offering a certain type of product, and it wishes to provide a discount, it should be possible to do so. But that discount should not be so low as to jeopardize the entire airline industry, or to result in inequitable fares to the consumer.

Senator EXON. Or to go back to some form of what I earlier suggested by saying to them, under the free enterprise dog-eat-dog system, if you want to go in there and compete, then you are going to have to stay in there and compete at that fare for a longer period of time, so that you do not have this yo-yo approach of moving this highly liquid asset, which is an airplane, into Los Angeles for 2 weeks, and into Miami for 2 weeks, and into Honolulu for 2 or 3 months and then pull it out.

Are we not both talking about some form of stability in this marketplace that, in the end, would better serve the public and make the fares fairer than they are now?

Mr. TANEJA. Yes, Senator.

Senator EXON. Thank you.

Thank you, Madame Chairman.

Senator KASSEBAUM. Have you done any studies that would show what a distance-based structure would do to the profits of an airline?

Mr. TANEJA. I have thought about this, but I cannot show you the results of any in-depth analysis. It is something I am proposing to look at.

Senator KASSEBAUM. Let me introduce Mr. Armellino from Goldman, Sachs. It is a pleasure to have you here. People Express was hoping you were not flying from New York on their airline this morning.

Mr. ARMELLINO. I was not. They were full.

STATEMENT OF MICHAEL R. ARMELLINO, PARTNER, GOLDMAN, SACHS & CO.

Mr. ARMELLINO. The airline industry's predereguation financial history was among the worst in American industry since the airline's beginnings as a commercial enterprise. This was true despite a history of enormous strides in aircraft efficiency and exceptional unit volume growth by virtually any benchmark.

At the peak of the 1960–67 profit cycle, a period when high real economic growth and low inflation rates complemented the tremendous benefits from conversion from piston to jet fleets to produce a virtually optimum profit environment, certificated airlines earned a combined return on investment of about 10 to 12 percent. At the same time, American corporations in total were earning on average 10.5 to 11.5 percent on invested capital.

The record before and since those golden years, which look golden only relative to this industry's erratic financial history, was far worse.

In the recession of 1970, certificated airlines earned a 1.2 percent return on invested capital while American industry earned a return of about 7 percent. I should point out that a net loss can produce a positive return, since interest costs are added back.

In the subsequent economic recovery, airline return on capital peaked at 6.4 percent in 1974, a year when American business earned between 8 and 9 percent.

In 1975, U.S. certificated carriers earned 2.5 percent on capital, versus 6 percent for corporate America. The following recovery produced a 13 percent peak return for certificated airlines in 1978 and a 9 percent return for American business in total, which was a very rare reversal in form.

1978 marked the beginning of the deregulation era. In 1979, fuel prices rose 55 percent per gallon, followed by a 47 percent increase in 1980. Products made from oil account for a larger portion of airline costs than to any other industry except tire and rubber, and therefore, the negative impact of this oil price explosion was far

more burdensome to airlines than to almost any other American industry.

While fuel prices peaked early in 1981, in 1982 the economy plunged into the worst recession since the Great Depression. The trunk and regional airlines earned 5.3 percent on invested capital in 1981 and a nominal return in 1982. American industry earned about 9 percent in 1981 and 7 to 8 percent in 1982.

Therefore, the spread between the airlines' return and returns earned by the American industry in 1982 were worse than most cases in the past, but airlines have almost invariably lagged average returns in U.S. industry by a wide margin.

Compared with a long list of other highly cyclical industries, including automobiles, forest products, industrial machinery, and several others, deterioration in the airlines' profit performance was far less substantial relative to that in previous recessions.

This is not to say that deregulation has not hurt several airlines. I would be the first to admit that it has. Decades of cost passthrough pricing, and its predictable bloating of production costs, have made several airlines easy marks for low-cost producers. While no product is a textbook commodity, airline seats are closer than most. Deregulation converted a cost passthrough business with restricted entry and exit to a commodity business in which low relative production costs are the primary basis for survival.

High-cost producers, therefore, are extremely vulnerable since they are unable to compete over time on price and ultimately will fail unless they are able to redress their producton cost deficiency. I believe this to be one of deregulation's great merits, particularly for consumers.

It is highly improbable that Southwest Airlines or People Express would be offering their very attractive fares, I wish there were more seats, to consumers in an ever-growing number of markets if the airline industry had not been deregulated.

In general, airlines categorized as regionals predereguIation have greatly expanded their route systems in the 4 years plus since deregulation, an important measure because their fleets were more appropriately sized to markets served than trunklines that could not economically serve short to intermediate range markets competitively with 727/200's. Also, work rules tended to be less restrictive than for majors. Consumers paid for this inefficient allocation of resources.

Airlines categorized as regionals predereguIation accounted for about 7 percent of the combined regional-trunk market in 1977, the last full predereguIation year. In 1982, this same group of airlines, plus Southwest, PSA and People Express, accounted for more than 13 percent of the total, and this penetration will be close to 15 percent in 1983. Even this shift is modestly understated, since I have not included all the nonmajors.

For those who dismiss this existing share of this group of airlines as insignificant, a mistake other industries have made to their peril in evaluating competitive threats, and I cite automobiles and steels in particular, I might note the following.

Southwest Airlines now operates about 40 airplanes, versus only 13 at year-end 1978. Piedmont has been adding aircraft in larger numbers than any other airline. People Express, which just began

flying about 2 years ago, operates more than 20 airplanes and probably will be operating more than 50 airplanes by mid-1985.

To place this in perspective, even Southwest, with its sensational record of profitable growth, will have built a fleet of about 40 aircraft by the end of its 12th year. Meanwhile, several other regional airlines did manage a profit in 1982, including Frontier, Ozark, Piedmont, and USAIR, in addition to Southwest, Midway, and People Express.

The other side of deregulation is the tragedy of Braniff's failure and the undeniable financial decline, even compared to past recessions, of several others. However, I feel strongly that the freedom to fail, and the disinvestment that goes with it, is a necessary element in any business that is to be a healthy one.

The displacement of inefficient companies by efficient, well-managed companies not only rewards the employees, suppliers, creditors, and owners of the well-run enterprise, but consumers also, since the low-cost producer imposes a cost discipline that will be reflected in a reduced rate of inflation in selling price.

Before summing up, I would like to make one final point. Because the CAB protected airlines during recessions, usually by freezing market entry and allowing fares to rise significantly during periods of financial stress, marginal airlines invariably were able to survive.

This protection provided a real economic incentive for lenders to finance marginal airlines, since interest rates charged to these apparently high-risk credits were attractive to lenders, reflecting marginal financials, but interest and principal invariably were repaid.

This easy access to capital was conducive to capacity expansion even for airlines that rarely earned a profit. The result was chronic overcapacity. This, and the depressing impact on traffic of the unprecedented rise in fares in 1980, when effective prices increased 20 percent in response to the previously cited increase in fuel prices has resulted in chaotic pricing.

The enormous overcapacity fostered by years of protective regulation should be corrected. Only a recovery in traffic and a protracted period of disinvestment will cure this.

The process has already begun, with institutional investors more cautious than before in lending to airlines. The generally indiscriminate current public market appetite for airline equity, I believe, will prove to be a brief window, except for those companies with a record to support financing on merit.

I so often hear the claim that regulation produced the world's best air transportation system. My response is that the United States has enjoyed a superior air transportation system, but to credit regulation is stretching.

First, I should note that the United States has produced many businesses and systems that are far superior to those of other nations. Perhaps the fact that, even prederegulation, U.S. airlines were less regulated than those of other nations is an important reason for the relative success of our air transport system before deregulation.

Moreover, a study done for the CAB comparing air service in October of 1982 with October of 1978 demonstrated the following: De-

partures at 662 communities served by certificated carriers at 23 large hubs rose 6 percent over the 4-year period. Increases at 35 medium and 62 small hubs were 14 and 5.8 percent, respectively, while departures at 542 nonhubs declined 9 percent.

The weighted average produced a 4-percent increase. Considering the state of the economy and the effect of higher fuel prices on the cost of service, the record is commendable. Moreover, several smaller communities have had commuter operators displace certificated carriers.

No doubt service curtailments are painful to communities that have lost service. But maybe regulation was part of the problem. Perhaps many of these smaller communities enjoyed certificated carrier service before deregulation without the capability to support that service, or for political reasons.

And what about the taxpayers from other communities who subsidized these services? The fact that we cannot document this taxpayer cost as specifically as we can the number of communities that lost service should not make the former any more palatable.

I should also note that a large number of new airlines are waiting in the wings to start service. Not all will succeed, and most literally will not get off the ground.

But I can promise you that the threat of their presence and the rapid shift in market share that has already occurred from higher to low cost producers imposes a cost and in turn a pricing discipline for management and labor of the incumbents. Some are responding.

American Airlines' recent success in gaining significant improvements in work rules and pay scales from its mechanics was most impressive and, I believe, beneficial to American's employees as well as to its management and shareholders in improving American's competitive position and, therefore, the job security of its employees.

In sum, deregulation is in its infancy compared with the period of regulation, and the external environment for airlines and for most other industries has been a very difficult one over the last 4 years. Decades of regulation produced many distortions in the system, including chronic overcapacity and bloated cost structures for several airlines, which consumers paid for, and service that sometimes was not related to the willingness or the ability of a community to pay for that service.

During the transition to deregulation, several airlines that were relatively insignificant prederegulation or did not exist have turned in financial performances that are superior to anything they were able to achieve prederegulation, despite the external environment. And some of the larger airlines are getting their costs in order and finding new and effective ways to compete.

The old order was good only compared with some questionable benchmarks. The link between performance and reward is far tighter since deregulation, and on balance, this should produce better performance for more people than the old system did.

The notion that regulation would succeed if only we had better regulators does not hold much water. Large numbers of regulators came and went, but somehow none found the magic formula to satisfy any broad constituency, an issue that seems to have been over-

looked. Why do we assume that somehow the next group of regulators will bring new wisdom when those in the past never did?

Thank you.

Senator KASSEBAUM. Thank you very much.

You seem to believe that overcapacity is one of the major problems. Is that correct?

Mr. ARMELLINO. Yes.

Senator KASSEBAUM. And that increased traffic plus better management or financial advice will help?

Mr. ARMELLINO. No. Well, hopefully it will. I do not think that is the essence of the issue.

I think the essence of the issue is that before the industry was deregulated, there had never really been a failure, which I think is always symptomatic of an unhealthy business. It made more sense, for example, for a lender to lend money to Eastern Airlines which is on marginal credit, than to lend money to Delta. The interest rate charged Eastern was higher that it was for Delta, the returns were higher, but the lender always got every dollar back in principal and interest. So it was real economic inducement to lend to the marginal operator.

But when an airline borrows money, what they invariably do with that money is buy airplanes, and it seems to me, if everybody in the business can finance, what they do is buy assets and the effect of that is to depress the pricing structure. Now, the short-term problem is obviously one of new traffic, but I point out that if we will look at airline load factors for the 12 months through May of 1983, they are only about 2 percentage points lower than they were at the cylical peak in 1978, which I think is a very, very credible performance.

Now some people tell me that that is because we have a lot of price cutting. Yes, the airline business is a commodity business. It does not surprise anybody.

It is no mystery to anyone why, in the copper business or steel industry or aluminum, people cut prices in a recession. The airline business is a commodity business. They do the same thing.

I think it is just as interesting, though, that as load factors are firmed up, we are moving now into a seasonal and hopefully a cyclical recovery and air fares are up very substantially in just the last 2 or 3 months. Of course, airlines do not advertise when they raise fares. They only advertise when they lower fares. So maybe it is not as visible but I think clearly that's happening.

So I think it is this artificial inducement for lenders to lend to the marginal airlines when there was no risk of a failure, or very limited risk of a failure. In 40 years there had not been one of any size. So I think this has promoted this overcapacity problem.

Senator KASSEBAUM. So you think essentially the erratic behavior of the financial aspect of the airlines will work itself out, and you seem to believe it already is, in the fare war struggle. Mr. Willis of the Department of Transportation yesterday testified that 80 percent of the fares were discount fares now on the airlines. That seems to me to be quite an amazing figure.

Mr. Taneja testified that substantial losses exist even though traffic has increased.

Mr. ARMELLINO. The essential point is not whether traffic increases. It is whether revenue increases. Airlines have never been able to increase revenue at the bottom of a recession. You can raise fares and reduce traffic or reduce fares and increase traffic, but there is no evidence that I am aware of that you can do either one and raise revenue.

Revenue is strictly a function of the economic cycle. There is a fairly constant relationship between spending on air travel and the business cycle.

So I think what we have seen is a recession, and the recession, as has happened in most other businesses, results in overcapacity, not because the airlines have ordered too many airplanes in the recent past. As a matter of fact, look at Boeing's order book. There is a virtual absence of new orders in the last couple of years.

What I am suggesting is it was overcapacity built up over a long period of time prederegulation that caused the problem. I can't think of another industry in this country that would have thought that a 55-percent utilization rate, which used to be a very respectable load factor in the airline industry, was adequate. There was a tremendous amount of excess capacity around.

It was the only industry in the country that I know of that could operate at anything like that and think it is respectable. Well, somebody has to pay for that. Somebody did. The consumer paid for it.

Senator KASSEBAUM. But we have a number of airlines entering into the market now that weren't there. You have just pointed out the number of planes that some of the airlines are adding.

Do you think that is wise at this point?

Mr. ARMELLINO. You mentioned the People Express a little bit earlier. People Express started out operating 17 of the oldest 737/100's of the world. They weren't new airplanes. They were old airplanes. They were existing before.

But People Express, with their productivity, very high productivity and very low production costs, was able to put those in service and make money at much lower fares than the existing carriers. You know, the high cost producer in any commodity business likes to be a pricing statesman, except that he does not control price. The low cost producer controls price.

We are in the very early stages of deregulation and I think that, in any business, I do not understand why high cost producers should be protected. I do not think a failure of the airline is necessarily the worst thing in the world.

Just like the failure—you know, if General Electric could not get out of the computer business, it would have been very bad for General Electric. The fact that they could get out of that business, it seems to me, is very constructive, and it is in most other businesses.

I don't see why it should not be in the airline business. They should disinvest if they cannot compete.

Senator KASSEBAUM. Mr. Taneja, do you have any comments?

Mr. TANEJA. If I may add a couple of points. My colleague here has pointed to the profitable operations of Southwest Airlines and Piedmont. That is not to be denied, but if you take the nationals as

a group of 16 airlines, in the last 4 years they themselves have not done financially that well. Two or three out of the total have.

Second, are we now to say that since the smaller carriers have done well, then the larger carriers, which, Senator, still produce 75 percent of our air transportation activity in this country, should be eliminated? I find it very difficult to believe that Delta Airlines is not efficient and yet Delta Airlines, as I pointed out earlier, posted the third largest loss.

So even if we assume that there are other major carriers that are inefficient and should be let go, should we lose Delta, too, should we lose Northwest, too, and so forth? So we are talking about the trunks which represent 75 percent of this industry.

Two, yes, People Express is efficient, but it is efficient because of a number of factors. One is that it is using aircraft which are secondhand. How long and how many carriers can continue to acquire used airplanes and operate at lower fares? Eventually People Express will require newer aircraft. Eventually its cost structure will increase as its labor matures and as the company grows.

I would also like to mention one aspect of overcapacity which is interesting. I agree with my colleague that overcapacity has had significant impact with respect to the introduction of some of these lower fares. But, is overcapacity going to go away? In order to understand that, one must look at how this industry operates.

If an airline needs to get a competitive edge on the others, one way I know of, outside of fares, is to put in an extra departure, an extra flight. And the temptation to put in that fifth flight is very high if managers can justify the costs based on a nonartibrary allocation of its costs.

Yes, Mr. Vice President of Marketing, we can put that extra flight in if we price it the following way. So the temptation to have overcapacity is always going to be there because the nature of the industry is such that competitive edges are provided by putting in extra departure times, extra frequencies, more nonstops instead of one stops and so forth.

Mr. ARMELLINO. In the first place, actually he has understated his case. The majors are about 85 percent of the market. In the case of Delta, Delta's seat mile costs, in fact, as I say, it is difficult to believe they are not efficient. It is not a question of what we believe or do not believe.

The fact is prederegulation, we had a cost passthrough business and Delta was, relative to other airlines, very efficient. I think it is very interesting, though, that American Airlines, which is one of these major carriers we are talking about, was just able to negotiate an agreement with their mechanics which allows them to do things in terms of flexibility, hiring part-time people, incremental pay scales that are far better than anything they had before.

I think it was in part Delta's efficiency, Delta's ability, as well as Southwest's ability, to build out of Dallas, their complex is out of Dallas, that forced this on American Airlines. The fact that American Airlines was able to achieve that puts American in a much more favorable position than they were in the past relative to maybe Transworld which has signed a couple of labor agreements recently that do not provide for anything near what American was able to get from their unions.

So it really gets down to a question of managing your business. If Delta, for example, decides to go along and increase their pay scales 10 percent a year and they lose a competitive advantage, well, it will not be the first company that has matured.

On the other hand, I don't think it is inconceivable that Delta may decide to take a much harder line on inflation in its pay scales as a result of what American has done in part. So I do not think we should hold Delta up as being sacred in any way. They are in a competitive business now, and they will survive or not survive based on their ability to compete on costs.

The fact that People Express is using older airplanes is, I think, an interesting argument because the older airplanes, other things being equal, are less efficient. They were able to acquire them at very low capital costs and they have just bought a large number of used 727's.

It is interesting. Braniff fails and those airplanes will be repainted and flying with People Express' colors at substantially lower fares, the same airplane recolored with a different interior configuration.

People Express can make money on those airplanes, flying those airplanes, at much lower fares to the consumer than Braniff was. I do not know what is wrong with that. I think that is extremely constructive, that you can have this kind of redeployment of the same asset, same airplane.

One company can produce, because one company is much more efficient, produce the seat cheaper and pass that through to the consumer. I think that is extremely constructive to have that kind of redeployment of assets.

Senator KASSEBAUM. So you do not necessarily believe, Mr. Armellino, that it is necessary to try and find some mechanism for a guideline in the pricing structure, say either a distance-based systems, some mechanism to provide some——

Mr. ARMELLINO. I think it is an awful idea. You know, it is easy to sit here and say we should come up with something that works, except that I don't know anybody that has been able to do it yet. You know, we still have not found the regulator that is able to come up with these kind of magic solutions.

I just find the marketplace does a better job of it consistently. This thing about marginal pricing, you know, Transworld tried a couple of years ago to develop a major presence in the Florida market. They stayed for awhile and they got out because it didn't work. You cannot price that way forever.

I think, by allowing the low cost producer freedom to go into as many markets as they can handle, you know, if People Express overextends themselves they will pay the price. If People Express loses their productivity advantage, they will pay the price.

But it happens that way in every other business. I do not see what is wrong with letting it happen in the airline business. I do not see why the airline business should be different. It is going to take some time, though, to adjust the system.

You know, Pan American has come a long way from where they were 1 year or 2 years ago in bringing their costs into line. I do not know if Pan American will be a successful airline going forward,

but I can tell you they have brought their costs into line compared to what they were.

You know, it is interesting that the airline business, prederegulation, financially had a terrible financial performance. They had some of the best improvements in productivity of any industry in the country as a result of capital investment and yet they never really made any money. We had a cost—a labor group in aggregate which was the best paid labor group of any major industry in the country so we are not talking about people who are being oppressed because of pressure on their pay scales.

As a matter of fact, I think Southwest Airlines, after they had been in business about 12 years, they have just had some mechanics retiring with about $160,000 in their pension plan as a result of profit sharing because the company has been so successful and shared it with their employees.

I just do not think the idea of trying to set up—it sounds good until you try to get down and try to put together a pricing schedule that works. I have not seen anybody able to do it yet. I do not know why we are assuming that somehow somebody will come up with the magic. I would like to hear some specifics.

Senator KASSEBAUM. Thank you very much. Both of you have offered some, I think, important observations on this and we appreciate the testimony. I think the whole committee will benefit from studying it.

Thank you.

Mr. ARMELLINO. Thank you.

Mr. TANEJA. Thank you.

Senator KASSEBAUM. We are ready for the next panel.

Now we will see what solution the carriers have to all of this.

It is a pleasure to welcome, going from my left to right, Mr. Pareti, managing officer, People Express Airlines; Mr. Lazarus, senior vice president, external affairs, United Airlines; and Mr. May, president of Republic Airlines. Welcome, and I do not know who would like to go first.

Mr. May, shall we go reverse order?

STATEMENTS OF DANIEL MAY, PRESIDENT, REPUBLIC AIRLINES; MONTE LAZARUS, SENIOR VICE PRESIDENT, EXTERNAL AFFAIRS, UNITED AIRLINES; AND HAROLD PARETI, PEOPLE EXPRESS AIRLINES

Mr. MAY. Thank you, Chairman Kassebaum, and members of the subcommittee. I am appearing before you today representing an established airline and a new entrant. Republic Airlines is both.

It is the fifth largest domestic air carrier in terms of passengers, serving 150 cities, more than any other airline. It is also the largest new entrant since deregulation.

Exhibit B to my prepared testimony looks like the route structure of a large established airline, yet it shows only markets Republic has entered since October 1978. Republic has added more revenue passenger miles than any other carrier since then, half again as many as the total of four well-known new entrants, People Express, Midway, Jet America, and Muse.

Because of deregulation, the domestic airlines are offering the public far more and better service than they could have expected under regulation. This includes more nonstops and more competitive service plus a vast array of new single carrier services through the creation of strong connecting hubs. The one exception to this record is small city service, a problem which is covered in my prepared statement and which deserves your attention.

I mention these improvements in air service partly to underscore my support for deregulation. I do not favor reregulation. My concern is that we not lose the good things deregulation has brought us by refusing to recognize and correct its imperfections.

In the long run the success of deregulation depends on public confidence and support, or a sense that it works and that it does not result in hardship or unfairness for large numbers of Americans. At the outset we need to acknowledge that there is no such thing as total deregulation. We still have comprehensive safety regulation, consumer protection and other kinds of regulation aimed at protecting the public from extreme economic harm.

It could be argued that in some of these areas such as safety, market forces eventually would accomplish as much as regulation. In the process, however, a lot of harm might be done. Congress has therefore decided to strike a balance short of total deregulation.

The Airline Deregulation Act also struck such a balance and on the whole it was successful. There is, however, one major remaining problem, irrational pricing. It is a problem that can be corrected without reregulating to any significant degree. If we do not correct it, however, the entire structure of deregulation is threatened.

The pricing problem has several aspects. The first and most serious is below-cost pricing. In the first quarter of this year losses for the major airlines were close to $600 million. Since deregulation these airlines have had operating losses of close to $2 billion.

This is not the result of rising costs. Fuel costs are down. The rate of increase in labor costs has declined. The problem is that competition has driven prices below cost. This problem has been created partly by the CAB eliminating minimum price regulation 2½ years before the timetable of the Deregulation Act.

However, there is also the question whether below-cost pricing doesn't reflect more fundamental factors. Airlines compete by overproducing a perishable product, seats. Because that product is so perishable, it is easy to base prices on a very short-term view of cost, or in the case of giveaways, on an assumption that there is virtually no cost at all.

If an airline is financially weak, its focus tends to be on the short term, on generating cash rather than covering cost. Once one carrier prices that way, the other airlines are obliged to follow since their products are basically similar.

The result is the kind of harm we have been witnessing the last few years. The situation is relatively calm at this moment, but it only takes one airline to upset the applecart. It is hard to believe that it won't happen again.

While many consumers have benefited from below-cost prices, in the long run it is destructive. It is destructive of airlines and airline jobs. It is destructive of competition.

It threatens the improvement in airline services that route deregulation has brought. And in the long run, because of its effect on capital formation, it threatens the strength of the U.S. aircraft industry and the thousands of jobs that depend on it.

Another aspect of the problem is the relatively high fares paid by passengers where competition has not developed. Typically these are on thinner routes. Thinly traveled routes do involve higher costs per passenger but not enough to explain the difference the public has experienced such as having to pay as much to fly 400 miles as 2,400 miles. Besides not making economic sense, it isn't fair, and it undermines public support for deregulation.

Something needs to be done about both of these problems and given the financial condition of the airlines, something needs to be done about below-cost pricing right now. My suggestion is twofold.

First, a study is needed to determine whether below-cost pricing is likely to be permanent, and if so, what can be done about it without reimposing the whole structure of fare regulation. This study would be made by a commission of independent experts which would report to Congress at an early date.

As a second step, I propose that pending action by Congress on such a study, a zone of reasonableness be established for fares. That concept was embodied in law until January 1 of this year. The boundaries of the zone should be set so as to discourage destructive pricing without restraining price competition.

The zone should not and need not force any carrier to charge more than its cost. As illustrated by exhibit F to my prepared testimony, downward flexibility of even 40-percent below industry average cost would be adequate to accommodate even the lowest cost operators.

A mileage based formula with a zone of reasonableness would also tend to bring fares into a more reasonable relationship with distance while still allowing for the effect of traffic density on cost. Enforcement of the zone could be by private right of action. No tariff filings or regulatory structure would be or should be required.

Many supporters of deregulation seem to believe that if Congress considers any proposal to make deregulation more workable, the whole concept of deregulation may be lost. This is the domino theory.

In my judgment it will be harder to resist major reregulation if Congress doesn't do anything to address the present crisis. I, for one, have faith in Congress ability to fine tune deregulation without destroying it.

Thank you for your attention. Because of the limited time available, I would request that the text of my prepared testimony be included in the record.

Senator KASSEBAUM. It will be done in full in the record. Thank you, Mr. May.

[The statement follows:]

STATEMENT OF DANIEL F. MAY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, REPUBLIC AIRLINES, INC.

Mr. Chairman, and Members of the Subcommittee, it is a pleasure to appear before you on behalf of Republic, the company's 14,500 employees and, to some

extent at least, on behalf of the more than 150 communities in the United States that we serve.

Being asked to comment on the first four and one-half years of airline deregulation is rather like being asked into a family's home to discuss the merits of their four and one-half year old child. The child may be bright and promising, but it has also outgrown the stage where it can do no wrong. To grow to healthy maturity, it needs discipline and refinement. We feel the same about deregulation. Our overall verdict is positive, but we cannot ignore its weaknesses.

Recognizing that it is your child that I am about to talk about, I do have two general observations to begin with.

First, it is a truism that every industry involves some degree of governmental regulation. The diverse interests of our common constituency, the public, demand regulations addressing safety, consumer protection and a balancing of competing economic and social interests. In each case, the object is to strike the proper balance between the goal of competitive freedom and protection and fairness to the public. This is the pragmatic job of parenting, the kind Congress is uniquely suited for. Ideologies may be useful in setting goals, but they do not always adequately address the means. The real genius of the deregulation movement has been to pare down regulation to the point where it is as unobtrusive as possible, but the ultimate question still must be whether or not it works.

Secondly, just as the failures of airline economic controls in the early and mid 1970's created the backlash that led to the Airline Deregulation Act, the present system failures in areas such as pricing threaten to start the pendulum moving in the other direction. We sincerely believe that legislative responses to those failures are necessary, not to restore regulation but to preserve both the concept and reality of deregulation. Airline deregulation does not require either blanket endorsement or rejection. What it does require is fine tuning to make it work.

THE PLUS SIDE OF DEREGULATION

The greatest achievement of airline deregulation has been the improvement in service resulting from freedom of entry. As the CAB noted in its recent evaluation of deregulation, the domestic airline structure has rationalized itself into a system with a heavy emphasis on hubbing, i.e., with more single plane and single carrier service between and through hub airports. Overall, this is a system that is more efficient and better integrated than its regulated predecessor, and it has been achieved by eliminating the most visable and burdensome part of CAB regulation, the licensing of domestic routes.

I am hardly breaking new ground when I suggest that route deregulation has been a success. I do believe, however, that not enough credit for that success has been given to "incumbent" airlines such as Republic, the real "new entrants" in domestic air transportation. As the term "new entry" is used in Section 102(a)(10) of the Airline Deregulation Act, Congress recognized that such entry could come by "new carriers, the encouragement of entry into additional air transportation markets by existing air carriers, and the continued strengthening of small air carriers." Republic is the best example of the latter two forces at work.

Only five years ago, where Republic stands today stood three small local service airlines, North Central, Southern and Hughes Airwest. Today, Republic ranks sixth in terms of domestic operating revenues and fifth in terms of domestic passenger enplanements. Our fleet of 163 aircraft is one of the largest in the world, and we need to serve 112 airports within the U.S. in addition to 7 airports in Canada, Mexico and the Caribbean), more than are served by any other U.S. airline. The FAA classifies twenty-five airports as major hubs, and we service all of then except Pittsburgh, Honolulu and Newark (although we do serve La Guardia). Republic is the largest airline in terms of passenger enplanements at Detroit, Memphis, Milwaukee and Phoenix, second largest at Minneapolis/St. Paul, third at Atlanta and Las Vegas and fifth at Chicago. We have become a very big airline, not as large as the "Big Four" but nevertheless a carrier that is "major" is every sense of the term.

Exhibit A [1] identifies that 87 domestic nonstop markets that are served by Republic today but that were not served by its predecessors in October 1978. All of the post-deregulation "new entrants"combined cannot come close to matching this total.

The route map displayed in Exhibit B looks like the mature system of a very large airline, yet it consists solely of the new markets added by Republic since deregulation.

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[1] The exhibits referred to in this statement have been retained in the committee files.

Exhibit C examines the annual revenue passenger miles added to the operations of individual domestic airlines since deregulation. Republic ranks first, accounting for 12 percent of the total new entry. Interestingly, the four "new entrants" (People Express, Midway, Jet America and Muse) together account for only 8 percent of the total.

We are very proud of our accomplishments under deregulation, but that is not my reason for bringing them up. Rather, I want to emphasize that the continued success of deregulation necessarily depends on the continued success of established airlines such as Republic. An obvious point, perhaps, but one that is unfashionable because of the attention directed to new airlines. The development of new airlines is, and always will be, important under route deregulation. At the same time, policies and economic theories predicated on the assumption that new airlines will always be able to take up the slack and carry forward the positive momentum of deregulation are dangerously naive.

I would also ask that you keep this portrait of Republic in mind when you listen to our constructive criticism of deregulation. Republic, perhaps more than any other company in the U.S., has the most to lose in a return to a heavily regulated environment. At the same time, the deregulation that we value so highly is proving to be its own worst enemy.

THE MINUS SIDE OF DEREGULATION

Below-cost pricing

The most serious deficiency of airline deregulation has been in the area of domestic pricing policy. Route deregulation has worked well and deregulation has served to somewhat contain airline labor costs. Price deregulation, however, has not only failed to work, it has produced consequences so adverse that all of the benefits of deregulation are threatened. There may be some advantages to some consumers—or, more realistically, to selected consumers in selected markets—but they are more than offset by the threat to the basic competitiveness of the domestic airline industry and other adverse consequences for consumers. While no one is prepared to sacrifice safety or consumer protection in the interest of deregulation, there is an apparent willingness, even an eagerness, to sacrifice the quantity and quality of airline service.

No one intended that this happen, and no one even foresaw it as a possibility. Even the most ardent proponent of deregulation, the CAB under Chairman Fred Kahn, stated that "we do not believe the fear of destructive price competitive is a realistic one in this industry.[2] But it has happened, and the problem must be addressed. The fare chaos that has evolved in domestic markets does not necessarily undermine the marketplace theories underlying deregulation. What it does indicate is that unanticipated factors have intervened to the point where a "normal" marketplace does not yet exist.

Almost every domestic airline has publicly stated that this chaos must end. Unilateral efforts at solutions, for example American's recent attempt to introduce a mileage-based fare structure, have unfortunately met with only minimal success. This industry, and the nation it serves, must look to the Congress for help. Solutions are possible, as I will discuss later, and they all can be accomplished without reinventing regulation.

1. *The magnitude of the problem.*—For the airlines, the effects of below cost pricing can be seen on the bottom line of their P&L statement and in their balance sheets. Focusing on the major airlines, the airlines that account for 8 percent of all domestic rpm's, the first four and one-half years of deregulation were an expensive proposition:

TABLE I.—FINANCIAL RESULTS OF MAJOR AIRLINES 4TH QUARTER 1978 TO 1ST QUARTER 1983

[In thousands of dollars]

	Operating profit (loss)	Net profit (loss)
4th quarter 1978	91,264	80,698
Calendar year 1979	(9,122)	283,723
Calendar year 1980	(332,833)	4,166
Calendar year 1981	(542,000)	(729,400)
Calendar year 1982	(599,175)	(620,454)

[2] CAB regulation PS-80, at 39 (Aug. 25, 1978).

TABLE I.—FINANCIAL RESULTS OF MAJOR AIRLINES 4TH QUARTER 1978 TO 1ST QUARTER 1983—Continued

[In thousands of dollars]

	Operating profit (loss)	Net profit (loss)
1st quarter 1983	(567,443)	(552,401)
Total	(1,956,309)	(1,533,668)

Source: CAB Air Carrier Financial Statistics; results for 4th quarter 1978 through calendar year 1980 are for trunks plus USAir and Republic ("major" carriers since 1981).

A one and one-half billion dollar net loss hardly commends any program, whether it is called regulation or deregulation, and at a time when the entire economy has faltered, the airline industry has become one of its most troubled sectors. Exhibit D is a copy of an article in the May issue of Airline Executive examining the worsening balance sheets of U.S. airlines. It is a sobering analysis, and it concludes that the U.S. airline industry will have to generate profits of approximately $11 billion over the next four years to simply stay even.[3] The industry's need for reasonable future profits goes beyond the normal dictates of the marketplace. Environmental concerns, and the ability to meet those concerns with new technology, have the industry embarked on an equipment replacement course that will require (as recently estimated by the Federal Airport Access Task Force) an investment of approximately $100 billion for new aircraft purchases over the next seventeen years. These are impossible demands on an industry that, in its present state and if everything goes well, can barely break even.[4]

This crisis is often pictured as one of survivability. I prefer to think of it as a competition crisis. The profit motive is the engine that ostensibly drives the competitive forces in this industry. Absent the realistic ability to earn a profit, it is competition that will suffer the most. Several of the major airlines have already begun to position themselves in other service industries. Expansion by existing airlines, including Republic, has been greatly curtailed, new aircraft orders are far short of what they should be and start-up operations are now the exception rather than the rule. Given current trends, I can foresee the industry and most of its individual members surviving. However, I also foresee the evolution of an industry that will be subsantially less competitive (and less environmentally compatible) than its heavily regulated predecessor. That is not in our best interest, and it is not in the best interests of consumers.

For consumers, deregulation has produced very low fares in some markets and has encouraged fare differentials based on the quality and cost of service. Nevertheless, it has also produced fars that are totally irrational, discriminatory and confusing. There is no relationship between fares and distance, and it can cost as much for a passenger to fly 400 miles as it does to fly 2,400 miles. Fares on many longer routes are fixed below cost, and fares for many shorter distances are excessive. In fact, both anomalies go hand-in-hand, particularly for residents of small and medium size communities. Classes of travelers are discriminated against as frequently as classes of markets, and a business traveler may find that he is paying more than anyone else in the airplane one day, yet flying for free the next. Even the most experienced travel agent or airline reservationist finds it difficult to tell what the lowest fare is today let alone one week or one month from today. This destroys consumer confidence in airlines, makes long-term planning extremely diffi-

[3] While there was a general perception that prederegulation airline fares were too high, they were not high enough to permit the domestic airline industry to earn a reasonable return on its investment and to build a cushion for deregulation. In fact, between 1956 and 1978 the domestic airline industry exceeded a 10% return on its investment in only three years, and the typical annual return was in the range of 2 percent to 4 percent, performance that would be unacceptable in most industries.

[4] The problems of the domestic airline industry quickly have the problems of the airframe and engine manufacturers. An excellent survey of civil aviation in the May 28 issue of The Economist made the valid observation that "[t]he truth is that the airframe and engine makers are just like the airlines—they will discount their price time and time again in their deoperation to sell their products." The result has been a general decline in the fortunes of the manufacturers and a severe erosion of the traditional U.S. dominance in that industry. While the survey concluded with a note of hope for the future, largely because of the flexibility provided by route deregulation, it also noted that "[t]he problem will be getting to that future."

cult, causes multiple reservations and the consequent noshow/overbooking problems and encourages advertising practices that can often be misleading.

Perhaps the best question to ask is the following: if any of this had been predicted in 1978, would we have had airline deregulation in the first instance? Obviously not, and it was the existence of convincing arguments to the effect that these results were unlikely that created a consensus in support of deregulation.

2. *Some thoughts on the causes of the problem.*—We have given this problem a great deal of thought at Republic, as I am sure many other airlines have, and we would like to share some of our ideas as to why the unexpected became a reality.

While the softening of the economy has obviously exacerbated the problem, it has not been the cause. Traffic growth has not been as strong as some past periods, nor has it been as weak as some, and domestic rpm's for the twelve months ended October 31, 1982 were some 16 percent greater than for the twelve months immediately prior to passage of the Airline Deregulation Act. Costs are also not the culprit. Fuel costs have stabilized or gone down, and genuine progress has been made in addressing labor costs. The cause of the problem rests entirely with yields. Domestic airlines have simply been unable to charge enough to cover costs, let alone earn profits.

Republic, again, is a microcosm of the problem. While our operating results have consistently been among the best in the industry, the high debt cost associated with the merger and acquisition have given us the financial scars exhibited by most other airlines. In 1982, the average Republic passenger paid a fare of $95.00, and we suffered a net loss of $39.9 million. If that average fare had been $98.00, we would have broken even; and if the average fare had been $103, we would have earned a modest (approximately 5%) return on our investment. Why can't we collect that extra $3.00 or even the extra $8?

The answer is that we are often forced to sell seats below cost, or to even give them away, simply to match what our competitors are doing. The risk we run by not matching is a loss of traffic, and we typically have only hours to assess the seriousness of that risk. Our product is highly perishable, and the first rule is to cut down spoilage. Not that we wouldn't have discount and promotional fares absent the need to match competition. I think our Ralston Purina "box top" promotion last year is a classic example of a novel, cost-justified promotion that benefited both consumers and the airline. But in the first quarter of this year, our average yield was lower than it was in the same period of 1982, as it was for all other major airlines, and that is seat discounting carried to the ultimate extreme. The real tragedy is that most other airline chief executive officers would probably give the same answer.

The domestic industry has evolved into an environment of permanent price instability, one in which the "three dollar" difference appears as high as Mt. Everest. In all fairness, this instability is less a product of the terms of the Airline Deregulation Act than it is of the administration of those terms. Congress never envisioned that pricing policy would be the leading edge of deregulation. Rather, it anticipated that service and cost based pricing would evolve from a progressively deregulated domestic airline structure. To assure that progression, the Airline Deregulation Act included a "zone of reasonablenesss" approach to fare controls phased out over a period of more than four years, with continuing supervision of "predatory" and "discriminatory" pricing policies.

In actual fact, the CAB effectively eliminated itself from the domestic fare arena more than two months before passage of the Act and maintained a "hands off" attitude thereafter. Rather than pricing policy rationally evolving from an industry that had transitioned into a totaly free entry and exit environment, that had developed cost structures based on a free market and that had solved its immense capital formulation problems, pricing policy became the proverbial cart before the horse. In retrospect, instability was the only logical result of that scenario.

One other point to keep in mind is what I would call the "black hole" effect of airline deregulation. Most "nonregulated" industries are in fact subject to the pervasive controls of national antitrust policy. For a variety of reasons, including absolute jurisdictional bars, a lack of expertise in the courts and other agencies as far as aviation matters are concerned, and the perceived expertise and supervision of the CAB, those controls have not been applied to airline pricing. As an example, if a neighborhood supermarket employed the pricing practices common in the domestic airline industry—e.g., gross discrimination, rebating, bait and switch advertising and, in some instances, predation—it would have both consumers and several Federal agencies pursuing a variety of legal remedies. But what is prohibited in so-called "nonregulated" industries is encouraged in the domestic airline industry. Again, instability is the only logical result.

The only real question in my mind is whether below cost pricing is a permanent phenomenon in this industry or something that may pass after another five or ten years. While the answer to that question may affect the long-term solution to the problem, it does not reduce the need to do something today. Deregulation cannot survive even one more year of pricing chaos.

Service to small communities

There are more than 600 airports in the U.S. certificated to receive airline service. Approximately 4 out of every 5 of those airports is classified by the FAA as a "nonhub," small airports that each generate an average of only 50 enplaned passengers per day. One of the major concerns during the debate over deregulation was the extent to which the quantity and quality of this small community service could be maintained.

This concern permeates the Act. Incentives were added to the existing subsidy program under Section 406 to encourage carriers to maintain their services under that program, and an entirely new section (§ 419) was added to ensure the continuation of "essential air service" at small communities over a period of ten years. Unfortunately, economic realities have foreclosed many of the Act's objectives. Section 406 subsidy is coming to an end, and Section 419 subsidy has been used sparingly. Economic turmoil in the regional airline industry has resulted in frequent carrier turnover. The CAB, for its part, has interpreted "essential" to mean "minimal," and as a matter of general policy it will not guarantee more than 80 seats per day to one or two nearby hub cities, generally with the smallest available aircraft.

As a result, departures at most small communities have decreased since the Act was passed, and not only are the communities receiving fewer flights, the service they do receive is with smaller aircraft and is often not coordinated with the service of other airlines beyond the hub. The probability of self-sufficiency for small community air service by 1988, the goal of the Act, is an illusion, and a good argument could be made that the program has done more for intercity surface transportation than it has for small community air service.

Again, Republic's concern is based primarily on its own experience. Although Republic has become a very large airline, our roots rest in the small communities of this nation, and we still serve more of these communities than any other airline. Forty-one nonhub airports presently receive Republic service. Although we have terminated service at an almost equal number of nonhub airports in the last four years, we have attempted to the extent possible to work with the communities and the regional airlines to find replacement service. That task has proven quite difficult since, in many instances, the administration of the essential air service program produces negative incentives.

The only arguable benefit of this program has been some reduction in Federal subsidy payments, although the predereguation program was probably the most efficient and effective system of subsidization ever administered by the Federal Government. The costs, on the other hand, have been significant. Small communities are not just losing air service, they are losing an economic lifeline that in many respects is as important to their future as the interstate highway network. Regional carriers are often put in an untenable economic position, and many communities have witnessed the spectacle of a new carrier every year. Larger carriers such as Republic suffer a loss of traffic as the feed traditionally provided by the small communities is depressed by insufficient service.

In short, a situation has evolved that is one hundred and eighty degrees away from what Congress intended in 1978 and that is only going to worsen in the next five years.

SOME SUGGESTED OPTIONS

Pricing

The period from now through the "sunset" of the CAB on January 1, 1985 is undoubtedly going to be the most crucial period in the history of domestic air transportation. The final judgment on deregulation is likely to be based on what happens during this period.

Two purposes have to be addressed, and neither requires much regulatory intervention. First, the domestic airline industry has to be given time to catch its breath, to restore order to its pricing policies. This could be accomplished by a limited return to the Standard Industry Fare Level (SIFL) and the coexisting zone of reasonableness, adjusted to take into account all carrier costs including those of the "new entrants." This would really be nothing more than putting the deregulation of pricing back into synchronization with the other aspects of deregulation. It would

involve minimal regulation, and low fares and price competition would be both maintained and encouraged. The pricing structure that would be produced by this proposal would probably not be that different from the one in place today—but the "three dollar" difference would be addressed by limiting the ability of airlines to engage in prolonged discounting at fares well below costs.

This would also permit the second purpose to be addressed, namely, the creation of a commission to examine the question of domestic airline fare policy and to recommend a further Congressional response. I have advocated the creation of such a commission for a number of months, recognizing that my views or the views of anyone else intimately involved with domestic air transportation and deregulation are understandably colored by subjective interests. The views of an independent, third party are sorely needed. The commission would have the distinct advantage of being able to assess what actually happened in the marketplace during the period of strict price regulation as compared to what happened when the industry had absolute pricing freedom. It would also have access to the experience with the limited pricing controls I described above. In other words, it would be able to base its recommendations upon facts, not theories, and should be able to realistically tell the Congress what will and will not work.

In the longer run, some answer needs to be found for the discrimination problem. We also need to more carefully define predatory pricing and to provide other disincentives for carrier overreactions to price changes by competitors. All of this can be accomplished without creating a new layer of Federal regulation.

Small communities

The CAB must be told that "essential" air service means something more than minimal air service. It should also be directed to look at the larger end of the small community essential air service funnel, the service beyond the hub. Carriers that serve the hubs need as much of the small community feed traffic as they can get; and passengers to and from small communities need reliable service beyond the hubs. The matching of these reciprocal needs would provide a non-subsidy incentive for improved small community service. Consideration should be given to exchanging exclusive right at small communities for commitments by carriers or combinations of carriers to provide good service to and beyond hubs. The concept of exclusive rights to serve a community may be anathema to a strict deregulationist, but if the community has never been served by more than one airline and better service can be provided without the use of subsidy, why not use this tool to correct a defect in the marketplace?

Retail distribution systems

One factor on the minus side of deregulation that I did not discuss was the potential damage that has been done to the existing retail distribution systems. These are really two interrelated problems. On the one hand the CAB is embarked on a course of stripping antitrust immunity from the existing systems established by intercarrier agreements, for example the ATC travel agency program and the SATO program for government installations. On the other hand, a few of the very largest airlines, most notably American and United, are using their leverage in the marketplace to control travel agents through the use of automated reservations systems. These problems are being discussed in other forums, and I would confine my observations today to the following:

The CAB's decision in the *Competitive Marketing Case* must be overturned. It is wrong as a matter of fact, and it is wrong as a matter of law—points that will be raised in the case of *Republic* v. *CAB* pending in the Eighth Circuit—but is also eminently bad national policy. If the present system of 20,000 travel agents did not exist, it would be a major achievement of deregulation, and a major boost for competition, to have that system created. Yet the fact that it is already there and predates deregulation is, in the view of the CAB, adequate reason for imperiling its future existence. Somewhere along the line, theory overtook reality, and Republic strongly supports any legislative effort to correct that situation.

The CAB cannot be permitted to write the antitust immunity provisions out of the Act. Congress has consistently recognized the necessity for antitrust immunity in certain special circumstances and the CAB should be told to honor those provisions.

The problem with automated reservations systems such as Apollo (United) and Sabre (American) is the age old problem of the fox in the henhouse, and it goes well beyond bias. The ultimate solution to the problem—and it is one of the most serious threats to competition in the domestic industry—must consist of efforts that encour-

age non-airline systems, multi-carrier systems and/or multi-carrier bargaining with existing providers.

CONCLUSION

There is absolutely no reason that we cannot continue to have the finest air transportation system in the world. For Republic, and I suspect for most other carriers, the Airlines Deregulation Act was an important step in accomplishing that goal. But at the same time we cannot ignore the problems. Those problems can be addressed without restoring regulation or adversely affecting competition, and they are going to have to be addressed before the solutions are out of our grasp.

Thank you for your consideration and attention.

Senator KASSEBAUM. Mr. Lazarus.

Mr. LAZARUS. Thank you, Madam Chairman. I, too, have previously submitted a more detailed statement of United's position to you and request that the statement be made a part of the record. We appreciate the opportunity to testify about United's views on the phasing in of deregulation.

The reasons for our unyielding support of deregulation are not very complicated. For the first time management is responsible for its own destiny. Our experience conclusively demonstrates to us that a regulator, no matter how wise and public spirited, is no match for the crucible of the market place.

Perhaps the single most significant change worked by deregulation is that it forced us to become more efficient in order to become more effective competitors. In the free market inefficient companies fail, while efficient ones do very well indeed.

The transition from tight economic regulation to deregulation is not easy. For 40 years airlines had grown accustomed to operating under Government scrutiny and control.

Furthermore, we also had three unexpected blows. First, the skyrocketing price of jet fuel is just now leveling off. At United we paid $195 million for fuel in 1973. By 1982 we paid $1.4 billion. That comes to about $3,000 a minute around the clock just for fuel.

Second, the prolonged and deep recession has had a serious effect on United and most of the industry. Recession led to decreased demand which produced excess capacity and price cutting.

Third, the illegal strike of the air traffic controllers in August 1981 had immediate operational and financial consequences. It has also had continuing disastrous consequences for United because our principal hub at Chicago was hit harder than the rest of the country.

As we review the early stages of deregulation, our conclusion is that we would not have been able to cope as well with the consequences of fuel price increases, recession and the controllers' strike under regulation as under deregulation. Why?

Because we had insufficient flexibility under CAB regulation to adapt our prices or route structures to changing circumstances. Faced with sharp increases in a price element under CAB regulation, we would have applied to the Board for pricing relief which invariably was too little and too late.

From an overall viewpoint deregulation has produced massive public service benefits. The details are set forth in our prepared statement.

But let us focus now on the critical issue of pricing which has drawn so much attention. The Airline Deregulation Act phased in

pricing freedom after free entry had taken hold. This phasing process served to insure that competition would be in place in order for marketplace forces to work and that is what is happening.

We have several observations about pricing policy and practice under deregulation. First, although there are critics of market-by-market pricing, the overall system has worked to the public's advantage. Fares have increased less than the Consumer Price Index.

During a period of severe inflation air carrier prices lagged. Why? Basically because of competition.

Second, there is progress in simplifying an admittedly complicated pricing system. That is going on now.

Third, it is not unreasonable to have extensive fare cutting in certain dense markets during a recession. There is absolutely nothing irrational about airline pricing. Our business is really no different from other businesses.

In a period of decreased demand, overcapacity generally follows. Business reacts two ways. It reduces capacity where it can do so economically and efficiently. It is difficult for air carriers to cut very much capacity because of high fixed costs and the need to continue a high level of public service.

So air carriers do what other businesses do. We pursue the marginal dollar by offering cutrate prices. When recovery occurs and overcapacity is not a serious problem, extreme rate cutting will disappear and that is happening right now. There will, however, almost always be discounts and bargains in a free market because of actual competition and the threat of competition.

There are some critics who charge that recent pricing actions have unfairly discriminated against the small communities where deep discounts have not been offered. We appreciate the critics' concerns but respectfully disagree with their conclusion that some form of reregulation should be enacted.

Small communities are normally located along short, thin route segments. On a cost relationship basis which is standard and logical for the establishment of prices, short, thin segments bear a higher per mile cost than dense longer segments. These costs are anywhere from three to five times higher.

When pricing was regulated the longer routes actually subsidized the shorter routes, but it makes no economic sense for longer routes to pick up the burden of the shorter routes. Here is where the benefits of the competitive market are seen. It is economic reality that when the price gets too high in a free market, a lower priced competitor emerges.

It is also true that because of the hub-and-spoke system travelers from smaller communities do reap the advantages of market-by-market pricing. Passengers from Grand Rapids, for example, usually continue their journey beyond Chicago.

For the third quarter of 1982, 84 percent of United's Grand Rapids-Chicago passengers connected at Chicago to travel to or from destinations beyond Chicago. Those passengers can and do take advantage of discount fares from Chicago to distant points on United's system. All major carriers operate that way.

There is another side to this issue. Supposing that small communities are to receive pricing protection either by putting a ceiling on fares to those communities or by insuring that long-haul fares

somehow maintain a percentage rate relationship to short haul fares or by some other artificial pricing mechanism such as the return to the so-called zone of reasonableness.

What would happen? In many cases carriers would simply abandon the smaller uneconomic communities.

Suppose then that the Government protected both small community fares and small community services by prohibiting exit. Then the free market would be obstructed, inefficiencies would appear, prices would go up around the system, and the general public would bear the unnecessary increased cost burden.

A zone of reasonableness would produce the same result and return us to the days when efficient carriers were penalized and inefficient carriers were protected. Management does not need or deserve protection against its own actions.

We are not a public utility any more than the neighborhood grocery store, and thanks to Congress the deregulation act recognized that. In short, it is not possible to undue what deregulation has accomplished either by total reregulation or by partial fare regulation. We have to be prepared to accept the economic reality of the free market or to destroy the existing system and attempt to return to the inefficiency, waste and cost of a regulated system.

In our judgment the choice is clear and the conclusion is obvious. The free market is more efficient and wiser, if you will, than any system of economic regulation.

Thank you.

[The statement follows:]

STATEMENT OF MONTE LAZARUS, SENIOR VICE PRESIDENT—EXTERNAL AFFAIRS, UNITED AIRLINES, INC.

Mr. Chairman and members of the committee: I am Monte Lazarus, Senior Vice President—External Affairs, United Airlines.

We appreciate the opportunity to testify about United's performance since the phasing-in of deregulation. We shall also focus on the future course of deregulation.

United was the first—and for a long time the only—air carrier to support deregulation. At the threshold we have two comments about that. First, United is now even more firmly committed to deregulation as the proper course to follow for the traveling public, shippers, shareholders, and the airlines themselves. Second, we are pleased that today the airline industry solidly supports the principles of deregulation. That's quite a testimonial considering the financial battering the industry has endured the past several years.

The reasons for our unyielding support are not very complicated. For the first time management is responsible for its own destiny. We shall win or lose on the field of competition. How well we perform will determine whether the public will or will not use our service, and whether we make a profit. This is in sharp contrast to the days when our results were determined not so much by our performance in the marketplace, but by the judgments and actions of Federal regulators. Our experience conclusively demonstrates to us that a regulator, no matter how wise and public spirited, is no match for the crucible of the marketplace.

Perhaps the single most significant change worked by deregulation is that it forced us to become more efficient in order to be effective competitors. Prior to deregulation we operated over routes subject to artificial constraints and restrictions which burdened our cost structure and limited our revenue generation. Our fares were set according to a CAB formula which worked on the basis of industry average costs. Because of United's size, we always were virtually the average, which meant we could never do very much to benefit from efficiencies. Various pass-through mechanisms compounded the fare problem and insured that inefficient companies would continue to exist, while only one or two could prosper. In the free market, inefficient companies fail, while efficient ones do very well indeed.

To underscore the point, note that in the years prior to deregulation the airlines were last among the top thirty industrial groups in the United States in rate of

return. We were just behind the railroads. There was not much hope of improvement because entry was limited, fares were controlled upward and downward, and carriers were bloated and inefficient without any driving incentive to change. Those factors led United to support deregulation in the first place. Events of the past four years have confirmed our analysis and conclusions.

The transition from tight economic regulation to deregulation is not easy. For forty years airlines had grown accustomed to operating under government scrutiny and control. We're on a very steep learning curve. It's fair to say that no entire industrial segment in the United States has had to face such a dramatic change in the rules under which it did business. We knew that there would be serious problems during the transition to a deregulated system. I'm not sure that we were aware just how difficult it would be to orient our thinking to the free marketplace.

Furthermore, we also had three unexpected blows:

First, the skyrocketing price of jet fuel is just now leveling off. At United, we paid $195 million for fuel in 1973. By 1982, we paid $1.4 billion. That comes to about $3,000 a minute around the clock, just for fuel. The unparalleled increase in jet fuel prices has a serious impact on the cost structure of every air carrier, and necessarily affected our price to the public.

Second, the prolonged and deep recession has had a serious effect on United and most of the industry. Recession led to decreased demand, which produced excess capacity. As with any industry faced with excess capacity, the struggle then follows for the marginal dollar. That means massive price cutting which we have seen for several years. It will take sustained recovery and the soaking up of excess capacity before some of the more confusing and irrational fares disappear.

Third, the illegal strike of the air traffic controllers in August, 1981, had immediate operational and financial consequences. It has also had continuing disastrous consequences for United because our principal hub at Chicago was hit harder than the rest of the country, and is rebuilding more slowly than any other center. United has been at a competitive disadvantage since the strike began, and we continue to operate under that handicap without substantial relief in sight.

As we review the early stages of deregulation, our conclusion is that we would not have been able to cope as well with the consequences of fuel price increases, recession and the controllers strike under regulation as under deregulation. Why? Because we had insufficient flexibility under CAB regulation to adapt our prices or route structures to changing circumstances. Faced with sharp increases in a price element under CAB regulation, we would have applied to the Board for pricing relief which invariably was too little and too late. And while there is always incentive to manage costs, there was nothing comparable to the incentive we have today to control the cost structure.

We have analyzed United's productivity on a company-wide basis, going back to 1973. Using 1973 as the base year, in the period of tight economic regulation, between 1973 and 1977, United's productivity decreased. However, beginning in 1977, when CAB Chairman Kahn unleashed the forces of deregulation, United's productivity has consistently improved with the exception of 1979 when United suffered a 58 day strike. Attachment I sets forth the detail on United's productivity. In addition to the yearly figures, we have included a sample monthly breakout using the month of March. This normalizes for the 1979 strike and, to a lesser extent, the controllers' strike. Both sets of figures graphically tell the story of United's dramatic productivity improvement.

Our fuel management system, for example, is superb. It's superb because we have to control fuel costs to remain competitive with carriers who have lower overall cost bases. We control fuel costs with new fuel efficient aircraft, with reengined, efficient DC–8–71's, and with procedures and management techniques using computer technology and the skills of our pilot group. A new entrant will usually operate with minimum cost aircraft, and low wage scales, and other low fixed expenses. Therefore, United and other older carriers must find ways to manage more efficiently, control costs and take advantage of markeplace superiority where it exists. This competitive environment exists because of deregulation and, in our judgment, is working as intended. It's no accident that our productivity has improved and facets of our operation, such as fuel management, are so well controlled.

It's too soon to tally all the results of deregulation, particularly because the industry has operated almost totally under the cloud of the recession and, more recently, the controllers' walkout. Nonetheless, some essential patterns of deregulation regarding routes and services, and fare structures are clearly emerging, and it's clear enough that deregulation is producing a more efficient, well managed, public responsive industry than in the days of regulation. Additonally, it is clear to us that

deregulation has had no impact on safety, which remains our number one priority. Let's turn to those issues.

ROUTES AND SERVICES

From an overall viewpoint, deregulation has produced massive public service benefits. Although the route structure was set free in statutory terms under the provisions of the Airline Deregulation Act of 1978, the conerstones were actually set in place earlier by the Civil Aeronautics Board under Chairman Fred Kahn. He and his colleagues set the tone for revolutionizing the industry. Deregulation has accelerated that process. The numbers speak for themselves. In the last four years, the number of scheduled carriers providing passenger services has jumped from 36 to 98, even accounting for defunct and merged certificated carriers. This increase includes former supplemental, intrastate and commuter carriers but, significantly, includes 22 air carriers that did not exist before deregulation. Contrary to the fear of some, these data clearly demonstrate that deregulation certainly has not increased concentration in the industry. In this context, it's noteworthy that no new scheduled carriers entered the domestic system for the last 20 years before deregulation. Since deregulation, new entrants have entered many markets, some have succeeded, others have not. Their share of the total market is now almost 8 percent.

Service has increased across the country. According to the Civil Aeronautics Board in a December, 1982, study, domestic departures between October, 1978, and October 1982, increased by 4 percent. This increase occured despite the triple impact of fuel cost increases, recession and controller walk-out we noted earlier.

You have received data from the Air Transport Association showing that the increases covered all hubs—large (6.2 percent), medium (14.1 percent), and small (5.8 percent). Only non-hubs—those with less than 45 daily enplanments—showed a decrease. But, that's to be expected in a free market environment.

The ATA has adequately covered the issue of assuring essential service and reducing subsidy, so we shall not repeat that data. There is one very critical point, however. In the ten years prior to The Deregulation Act, 173 communities lost air service. In the four and a half years since deregulation, no community has lost air service.

Let's examine what route changes United has made under deregulation and how those changes have affected the public.

United will serve 118 U.S. communities by July 1st, contrasted with 110 in 1978. We've added many communities, and have left some in favor of other carriers, usually commuters. The changes may be a bit surprising, so I'd like to go through some of them.

United has left the so-called "valley" cities in California-Merced, Visalia, Modesto, Stockton. United is out of Bakersfield too, and Charleston, West Virginia, Asheville, N.C., Chattanooga, Tennessee, Atlanta, Georgia, Newport News, Virginia, Muskegon and Flint, Michigan, Salem and Pendleton, Oregon, and Ely and Elko, Nevada. Those communities now receive service by replacement carriers. None of them has lost air service.

But, United is now providing excellent service to a host of new cities. This was not possible in the days when the Civil Aeronautic Board refused to grant any new routes to United. Interestingly enough, United's entry has not been confined to large hubs, or to services over dense routes. It's true that United has gone into Dallas and St. Louis, and has returned to New Orleans. But consider this list of other communities added since deregulation:

Burlington, Vermont
Sioux Falls, South Dakota
Wichita, Kansas
Tulsa, Oklahoma
El Paso, Texas
Austin, Texas
Syracuse, New York
Albuquerque, New Mexico
Phoenix, Arizona
Tucson, Arizona
Long Beach, California
Oklahoma City, Oklahoma
San Antonio, Texas
Orlando, Florida
Ft. Myers, Florida
Sarasota/Bradenton, Florida
Houston, Texas
Cincinnati, Ohio
Harrisburg, Pennsylvania
Kahului, Maui, Hawaii
Indianapolis, Indiana
Louisville, Kentucky
Anchorage, Alaska
Portland, Maine

This is a fair mix of cities, large, small and geographically diverse. Not only that, by removing previous CAB restrictions on United certificate, Congress has enabled United to make more sense out of its existing route structure and allow for more

efficient passenger oriented service. Our list of new communities is a testimonial to the contribution of deregulation, to the hub and spoke system, and to public service.

With opportunities offered by deregulation, United has consistently worked to build its hub and spoke system, emphasizing particularly the two major hubs at Chicago and Denver. It makes sense to feed traffic from smaller communities through the Chicago and Denver hubs where passengers can gain the advantage of United's extensive connecting banks to carry travelers virtually anywhere in the United States. In other cases, where market density warrants, United provides nonstop services between points on its system. Travelers benefit from the reliability and convenience of a large network, and United benefits from the efficiency of its improved system, and the ability to collect increased traffic at its major hubs. We also have been able to add significant north-south route segments to our predominant east-west route system. This is important to United, not only to make better use of its large fleet, but to smooth out some seasonal traffic imbalances which have hurt United over the years.

In summary, deregulation has produced service improvements to travelers, and opportunities for United which were simply not available in the 40 years of government regulation.

FARES

Airlines have been free to set domestic fares only since January 1, 1983. The Deregulation Act phased in pricing freedom after free entry had taken hold. This phasing process served to insure that competition would be in place in order for marketplace forces to work. And that's what's happening.

Industry financial results for the years since The Deregulation Act are not surprising. Heavy financial losses have plagued the industry, and United, for the past three years.

When The Deregulation Act was signed into law, we predicted that one result would be a difficult transition period as carriers jockeyed for position and experimented in the marketplace. Even that prediction did not anticipate the continuing effect of fuel price increases, and the ravages of recession.

We have several observations about pricing policy and practice under deregulation. First, although there are critics of market-by-market pricing, the overall system has worked to the public's advantage. Fares have increased less than the Consumer Price Index. During a period of severe inflation, air carriers prices lagged. Why? Basically competition. As the Air Transport Association pointed out several weeks ago, fares could have increased by 67 percent under the CAB's Standard Industry Fare Level Formula between 1978 and 1982. However, fares increased by only 48 percent. That's not just a statistic. Passengers are paying less than they would have paid if regulation continued.

Second, there is progress in simplifying an admittedly complicated pricing system. Some carriers have attempted to pare down the number of fares, to relate fares to mileage blocks, and to simplify conditions on discount fares. We believe this process will continue.

Third, it is not unreasonable to have extensive fare cutting in certain dense markets during a recession. Our business is really no different from other business. In a period of decreased demand, overcapacity generally follows. Business reacts two ways. It reduces capacity where it can do so economically and efficiently. It is difficult for air carriers to cut very much capacity because of high fixed costs and the need to continue a high level of public service. So air carriers do what other businesses do. We pursue the marginal dollar by offering cut rate prices. Automobile manufacturers do it, oil producers do it, hotels do it, retail stores do it—even airframe manufacturers do it. When recovery occurs and overcapacity is not a serious problem, extreme rate cutting will disappear. There will, however, almost always be discounts or bargains in a free market because of actual competition and the threat of competition.

This brings us to a fourth, and important point. There are some critics who charge that recent pricing actions have unfairly discriminated against some smaller communities in which steep discounts have not been offered. We appreciate the critics' concerns, but respectfully disagree with their conclusion that some form of re-regulation should be enacted.

Small communities are normally located along short, thin route segments. It is more costly to serve these segments than longer, denser segments. On a cost relationship basis, which is standard and logical for the establishment of prices, short, thin segments bear a higher per mile cost than dense, longer segments. Those costs are anywhere from three to five times higher. When pricing was regulated, the

longer routes actually subsidized the shorter routes. The CAB formula was skewed that way. But, it makes no economic sense for longer routes to pick up the burden of the shorter routes. And, here's where the benefits of the competitive market are seen. It is economic reality that when price gets too high in a free market a lower priced competitor emerges. The emergence of new low price carriers, such as People Express Airlines, and Mid-Pacific Airlines, is the direct result of this phenomenon.

It is also true that, because of the hub and spoke system, travelers from smaller communities do reap the advantages of market-by-market pricing. Some critics have complained about discounts being unavailable to travelers out on the spokes of the system. Not true. Passengers from Grand Rapids, for example, usually continue their journey beyond Chicago. For the third quarter of 1982, 84 percent of United's Grand Rapids-Chicago passengers connected at Chicago for travel to or from destination beyond Chicago. Those passengers can, and do, take advantage of discount fares from Chicago to distant points on United's system. All major carriers operate this way. So, it's not reasonable to look at any community in isolation. We're examining a network.

There's another side to this issue. Suppose that small communities are to receive pricing "protection" either by putting a ceiling on fares to those communities, or by insuring that long haul fares maintain some percentage relationship to short haul fares, or by some other artificial pricing mechanism, such as a return to the so-called zone of reasonableness. What would happen? In many cases, carriers would simply abandon the smaller uneconomic communities.

Suppose, then that the government "protected" both small community fares and small community services by prohibiting exit. Then the free market would be obstructed, inefficiencies would apppear, prices would go up around the system and the general public would bear the unnecessary increased cost burden.

A zone of resonableness would produce the same result, and return us to the days when efficient carriers were penalized and inefficient carriers were protected. Management does not need or deserve protection against its own actions in our business. We are not a public utility any more than the corner grocery store. The Deregulation Act recognized that.

In short, in this area is is not possible to undo what deregulation has produced and to tear away the fabric of the new air transportation network. We have to be prepared to accept the economic reality of the free market—or to destroy the existing system and attempt to return to the inefficiency, waste and cost of a regulated system. In our judgment, the choice is clear, and the conclusion is obvious. The free market is more efficient and, wiser, if you will, than any system of economic regulation.

SAFETY

In our business, there is simply no compromise with safety. At United, safety is the number one priority. Other air carriers have the same dedication.

Congress was properly concerned with airline safety when The Airline Deregulation Act of 1978 was written. The Act was confined to economic issues, and the Federal Aviation Administration's role as regulator of aviation safety remained unchanged.

Nevertheless, Congress required an annual report from The Secretary of Transportation on airline safety. Those reports demonstrate that the airline safety record under economic deregulation matches or exceeds the safety record in prior years. The record substantiates the conclusion that airline safety has suffered no adverse consequences as a result of airline deregulation.

CONCLUSION

As the transition continues from government regulation to the free marketplace, the evidence mounts that deregulation is working as intended. Public benefits have increased, in terms of choice and volume of service, schedules and fares. Air carriers, although buffeted by the winds of recession, have become leaner, tougher competitors, and are in position to achieve sustained earnings when the national economy recovers.

Efficient operators now have the opportunity to grow and prosper, while inefficient operators risk failure. By contrast when the government controlled routes and fares, efficient operators did not receive their full rewards, while inefficient carriers were propped up by government actions at the expense of the public.

A bankruptcy in the airline business, as in any other business, is tragic. The effect on the lives and fortunes of employees and shareholders can be catastrophic. But, the public, at most, suffers short term losses and inconvenience. There are

always other carriers to enter markets and replace failing carriers. One clear fact about the free market should not be ignored. If there is a need for a product or a service, someone fills that need with the appropriate service at the appropriate price. If the market need is inadequate, then it is up to you—to Congress—to determine whether you want to subsidize service and price at the expense of the general public. In truth, the airlines are like any other unregulated business and should be treated that way.

Finally, the egg of deregulation has been well scrambled and there is no way to unscramble it. To restrict entry, to prevent exit, to impose regulations of fares, should clearly be beyond debate by now, The deregulation process which is now moving along so well should be allowed to continue as the CAB fades into the sunset.

Thank you, again, Mr. Chairman, for this opportunity.

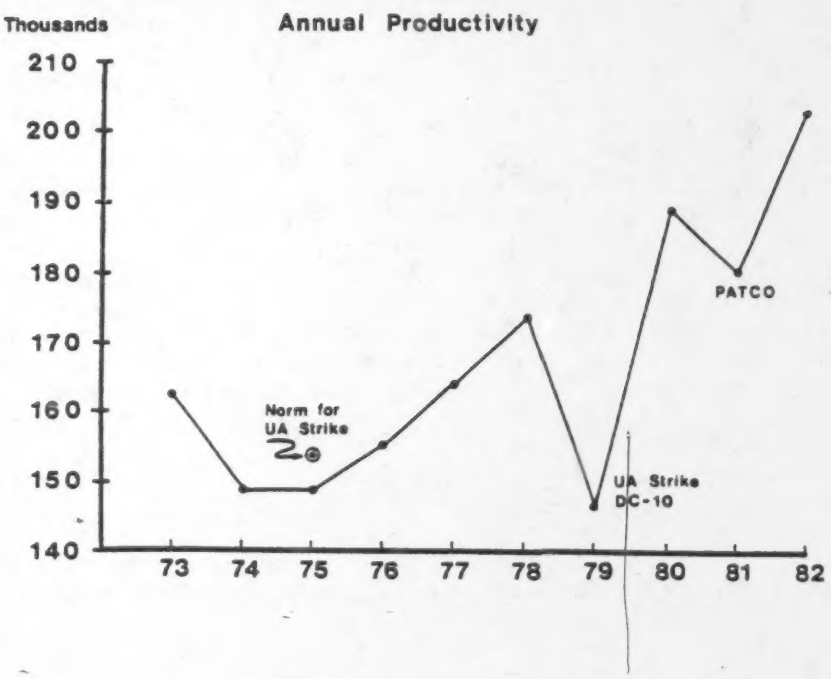
UNITED PRODUCTIVITY

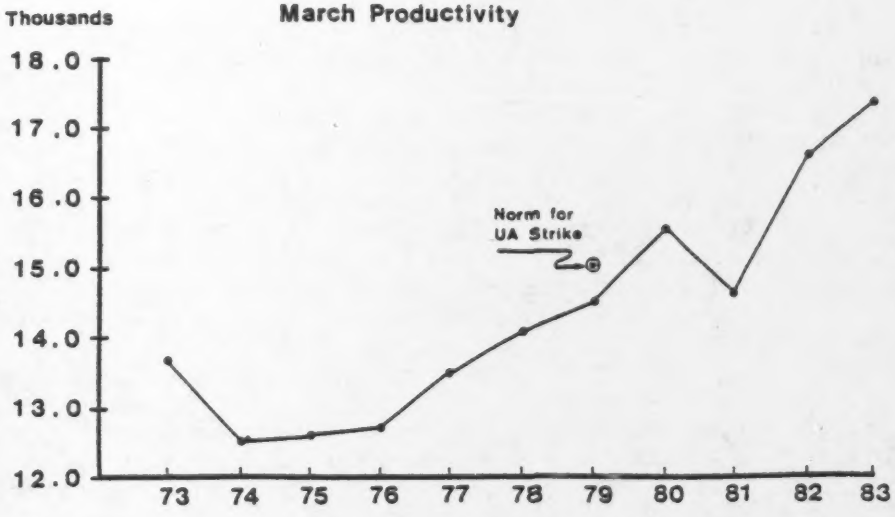
[ATM's employee]

	Annual		Month of March	
	ATM's employee	Percent change from 1973	ATM's employee	Percent change from 1973
1973	162,000		13,700	
1974	149,000	92	12,500	91%
1975	[1] 149,000	[2] 92	12,600	92
1976	155,000	96	12,800	93
1977	164,000	101	13,500	98
1978	173,000	107	14,100	103
1979	148,000	91	[3] 14,500	[4] 106
1980	189,000	117	15,600	114
1981	180,000	111	14,700	107
1982	203,000	125	16,600	121
1983			17,300	126

[1] 153,000 N.
[2] 94 N.
[3] 15,000 N.
[4] 109 N.

UNITED PRODUCTIVITY
Total Company
ATM's / Employee





Senator KASSEBAUM. Thank you.

Mr. Pareti.

Mr. PARETI. Thank you, Senator. We have also prepared written comments that I would like to have entered into the record.

Madam Chairman, on behalf of all the people of People Express it is certainly an honor for us to be here today, a company that is barely 2 years in operation, to present our views on deregulation. I think it is particularly appropriate for People Express to present its views for, were it not for your activities and the activities of Congress in passing the Airline Deregulation Act, we would not be in business today.

I think the success of People Express, the new service we have brought, the lower prices, the innovative service product, proves the wisdom of Congress in passing the Airline Deregulation Act, and we urge you not to be detained from that progress.

In analyzing deregulation, it must be remembered that the foundation of the American enterprise system is predicated on a belief that competition works. The competitive market place without Government regulation is the most efficient allocator of resources.

Deregulation in the airline industry has produced a very competitive structure. Yes, there have been failures, but those failures are not failures of the law. They were failures of management. The law did not provoke carriers to change from a commuter to a jet operation or to buy additional equipment or to add new cities at a very rapid rate.

That was management's decision to do so and to the extent it proved unprofitable resulting in bankruptcy, it is the management of those companies that should be looked to and not the law.

I would like to spend a few minutes on People Express and the impact we have had on the marketplace under deregulation. In passing that law, Congress promoted new entry in the airline industry.

There are a group of us that, at a time, worked for Texas International Airlines. We saw the opportunity that existed. We came together and created People Express.

The airline was conceived, born, weened and, some may claim, growing up very quickly all under deregulation. Over the course of the last 2 years, we have amassed over $180 million in assets. We have hired some 3,000 employees from the Newark, N.J., area.

Today we are operating 22 737's, a 747 to London, and we integrated the first of our 37 727's just last week. Today People Express generates revenues of approximately $300 million annually, and by 1985 that should be in excess of $800 million. The company has a market value in excess of $400 million.

All of this has taken place over the course of the last 2 years, all as a result of airline deregulation. I think the success of People Express, a success which is enjoyed by other airlines as well, is the litmus proof test that airline deregulation does, in fact, work.

Let me focus on a few aspects of our service and the benefits that we have brought to the traveling public.

There is a lot of focus on airline service, what cities have benefited, which ones have not? Since starting, People Express has instituted service to 19 cities throughout the domestic system and to London, England.

When we first started, Newark Airport was an underserved, underutilized satellite airport, sitting in the shadow of LaGuardia and Kennedy. Today People Express alone has over 220 arrivals and departures a day at Newark International Airport. That will increase to over 500 over the course of the next 2 years.

We have taken markets, for example Newark-Buffalo, Newark-Norfolk market and increased the service in those markets by over two or threefold. In each one of those cases, it was not the existence of People Express service at the expense of existing carriers, but rather the market itself has grown substantially and, as a result, the consumers in those markets now enjoy the benefits of some 20 to 25 trips a day, as compared to 8 or 10 before our entry into the market.

What we have found is that traffic has increased substantially in each one of those markets, as well as between Newark and points like Jacksonville, Fla., Melbourne, Fla., we have seen increases of over 200 to 300 percent in the traffic levels since our entry into those cases.

Second, with respect to price, there is a tremendous amount of focus on pricing in the airline industry. We designed our product with the intent of offering the lowest price possible, not because we are altruistic, but, in fact, we believe that the revenues we can generate are greater at a lower price than if we charged higher prices.

So to do so, we designed an organization that could produce a 5-cent seat-mile, so we can, in turn, offer an 8-cent yield on our prices and provide the benefits of those lower prices to the consumers and, in turn, make a profit for the company.

So, in fact, when we start service to new cities we often decrease the prices by as much as 60 to 80 percent below the existing levels when we enter the market. For example, the Newark to Pittsburgh market, the coach fare in that market was $123 when People Express entered the market. We now provide service at $35 during peak periods and $23 during off peak periods.

What you have found is a market that had over a million passengers traveling in it before our entry. Today, People Express alone carries over 500,000 passengers on an annual basis between Newark and Pittsburgh, all at very low prices, all at extremely large savings to the consumer.

What is extremely important to focus on, as you look at that whole pricing issue, as well, is: Should the consumer have to pay higher prices by Government edict because of a zone of reasonableness? We think certainly not.

We have been able to design our product so that it can, in fact, offer these low prices and yet produce a profit for ourselves and our shareholders. The consumer should not have to pay higher prices because of the inefficiency of our competitors or the system as a whole.

The third aspect of my focus is on capital formation. The American investment community looks to efficient, well-run, well-managed, highly profitable industries within which to invest the capital dollars available.

In the short history of People Express, we have had three public stock offerings, which has amassed over 85 million in equity funds for the airline. We are today capitalized in excess of $160 million.

As I mentioned earlier, the airline has over $400 million in equity value today.

This is money that could have gone to other industries. It could have been withheld from the marketplace but, in fact, the investment community has seen the opportunity for a growth in their investment funds and have, in fact, invested in our airline.

The same is true with Midway, with Muse Air, with some of the existing carriers. The continuous increase in that equity funding is a real benefit for this industry.

Does all this work? That is a very important question. The benefits that we have brought to the marketplace, in terms of our existence, new service, the prices that we have brought have, in fact, resulted in profits for the airline.

During 1982, our first calendar year of existence, we were one of a handful of airlines that enjoyed an operating as well as a net profit. We had a substantial profit in the first quarter of this year, in fact, the largest profit on a per share basis of any airline in the United States. I think this is testament to the fact that new entry and low fares can, in fact, be profitable.

Often in evaluating deregulation, the analysis stops at that point. We think there is a far bigger issue to look at as you evaluate deregulation and its impact. In order for American business to compete effectively in a world economy, it must be efficient, it must produce its product at a low price and it must offer value to the consumer.

When we established People Express, we established a precept for the company, and that is to be a role model for American business. We wanted to organize ourselves in a fashion that we could, in fact, produce a very low-cost product, pass on those low costs to the consumer in the form of lower prices and, in fact, not do that at the expense of the employee, but rather enhance the role of the employee within the company. So we have done a number of things.

First and foremost, all of our line producers, our pilots, our flight attendants, our ground agents are managers in the airlines. In fact, we have not hired a single individual outside the context of those employees to work for People Express.

What we do is cross-utilize all of these people in both their line function, be it flying an aircraft, working in the cabin of the aircraft or on ground operations, in the management of the airlines. What this produces is a well-trained, well-educated individual that not only contributes to line operation, but also participates significantly in the management of the airline.

That has two results. One, the role of the individual is enhanced substantially. That person can participate very substantially in the management and direction of the airline. The information, the experiences they gain on the flight line, they can bring into the management of the company.

Second, we can produce a 5-cent seat-mile as a result of that productivity. We find that the revenue per employee generated by the People Express employee is about three times the industry average. As a result of that massive productivity we can, in turn, offer low prices to the consumer at a profit to ourselves.

Finally, with respect to compensation, we have taken a very unique approach. All of our people are shareholders in People Express. In fact, among our pilot group, the average number of shares held is almost 3,000 shares per employee.

At today's market value, that is approximately $150,000 in net equity enjoyed on an average by the employees of our company. That type of awareness and familiarity with the company, participation in its growth as a shareholder of the company, contributes significantly to their role in the organization and how they produce the product.

The combination of all those factors from our standpoint not only produces a low cost product but produces a high value product. The combination of low cost, low price and high value is, in our opinion, the type of efficiency that American business has to produce if it is going to be an effective competitor in the world economy.

Finally, let me say that we believe very strongly that Congress should not tamper with the Airline Deregulation Act. The new entry, service flexibility and, particularly important, the pricing flexibility that is now enjoyed by the industry should continue.

The challenge of deregulation, Senator, is the freedom it allows for airline managers to be creative, to be innovative, to move forward or to remain static, to succeed or to fail. We believe the success of People Express and the success of other airlines that have followed us, as well as the success of the existing carriers that have successfully adapted to the new competitive marketplace, proves conclusively that deregulation was and still remains a correct decision. We strongly urge you not to reverse or detain the progress of that legislation.

Thank you.

[The statement follows:]

STATEMENT OF HAROLD J. PARETI, MANAGING OFFICER, PEOPLE EXPRESS AIRLINES, INC.

"It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of light, it was the season of darkness, it was the spring of hope, it was the winter of dispair . . ."—Charles Dickens," A Tale of Two Cities."

Madam Chairman and Members of the Committee, it is a great pleasure for People Express to appear before this Committee to discuss the state of the airline industry under deregulation. It is particularly appropriate for People Express to present its views because we would not have existed were it not for the enactment of airline deregulation. Our success, which I will describe below, proves the wisdom of Congress' decision to pass the Airline Deregulation Act.

Charles Dickens' excerpt above aptly characterizes the era of contrasts in which all of us in the airline industry find ourselves today. 1982 generally was not a good year for the airlines, and the first quarter 1983 financial results were also not very promising, (although, economic indicators show significant improvement). Therefore, to some carriers, it may indeed be "the worst of times." To others, however, like People Express who are growing and prospering, these may very well be "the best of times." While many may attribute their financial travail to airline deregulation, others can attribute their success to the same source. It is extremely fitting, therefore, for this Committee to undertake an evaluation of the state of the airline industry under deregulation at this time.

The Airline Deregulation Act was a landmark in legislation, representing one of the few times in which the Government recognized that regulation has outlived its utility. The concept of deregulation, however, is not a new one. Indeed, deregulation and the unfettered ability of the marketplace to regulate itself is the very foundation on which U.S. enterprise in this country has been built. As Thomas Jefferson observed in his first inaugural address on March 4, 1801, "Good government" is gov-

ernment "which shall leave men free to regulate their own pursuit of industry and improvement."

There is no more efficient allocator of resources than the competitive marketplace unencumbered by the heavy hand of subjective regulatory intervention. Each airline manager now has the virtually unfettered ability to fail or to succeed, to be creative or to be moribund through his own devices. Carriers will no longer be able to run to the government for help when things get tough. They will have to fend for themselves, to make adjustments—in some cases drastic ones—or they will fail. The rewards are great, the penalties are unforgiving.

The key to success in the airline industry today and in the years to come is dependent upon the ability of each airline to utilize effectively the freedom Congress has given it to create and innovate. This is the hallmark of a competitive marketplace.

People Express owes its very existence to the Deregulation Act. People Express is the first-born and perhaps the most successful, and fastest-growing progeny of airline deregulation. We started operations on April 30, 1981 and have grown to over $167 million in assets, almost 2,000 employees, and have a current operating fleet of 22 Boeing-737, serving 19 cities domestically, and a Boeing-747 for our New London-Newark service. By the end of this summer we will have taken delivery of six Boeing-727's and will be integrating 31 more Boeing-727's into our system over the next two years. To date, we have carried over 5 million passengers since start-up, and enplane over 400,000 passengers a month at load factors averaging in the 80's. We successfully completed three separate public stock sales, allowing us to accumulate over $80 million in equity capital. We made a profit in our first calendar year of operations, and first quarter 1983 results were excellent. We have accomplished all this in just over two years—a record of which all of us at People Express are justifiably proud.

People Express is on the cutting edge of what deregulation is all about. Deregulation is all about competition and the benefits that free competition will produce to consumers and to well-managed companies. People Express' mission and fundamental philosophy is to provide safe and efficient scheduled air transportation at the lowest cost to the traveling public. With fares that make flying cheaper than driving, People Express has developed brand new aviation markets generating passengers into the marketplace that had never before used the air transport mode. We are offering the traveling public a whole new innovative service product which unbundles from the pricing structure the cost of "frills" for which most passengers do not willingly want to pay. In short, we are providing the traveling public service and pricing choices which did not heretofore exist.

The success of People Express and other new airlines during the current period of national and industry recession is the litmus-test proof that deregulation in the airline industry is working—and must be maintained. Among the significant benefits produced by deregulation involve the areas of capital formation, increased competition and services, substantially lower fares, and new service innovations.

People Express successfully amassed over $150 million in equity and debt financing. Our success in obtaining new financing helped create a favorable environment for other new entrant airlines to obtain capital to commence operations. Through three public offerings of stock, People Express has been able to raise over $80 million in equity financing. This has undoubtedly encouraged other creative entrepreneurs to enter the airline industry through public/private capital arrangements.

People Express' innovative low-fare competition has greatly increased service opportunities for the traveling public and lowered airline prices. People Express has increased service dramatically to all of the cities and throughout all of the regions it serves. To illustrate, prior to the entry of People Express in the Norfolk-Newark/N.Y. market there were only 8 daily nonstop round-trips. Today, there are 22 round-trips. Similarly, in the Buffalo-Newark/N.Y. market, nonstop service increased by 100 percent. People Express currently operates 106 departures daily at Newark International Airport, making it the largest carrier at that facility, and making its hub the largest single carrier hub at any of the New York airports. Newark had once been described by the CAB as an underutilized secondary satellite airport in need of significant service increases. People Express' services at Newark have attracted other airlines to expand operations at that facility.

Among the most important public benefits of People Express' operations has been the dramatic lowering of prices in the markets it serves. The fares charged by People Express' range from 50 to 75 percent below the levels that prevailed prior to our entry into the marketplace.

FARES BEFORE AND AFTER PEOPLE EXPRESS

Market	March 1981	May 1981	Current
Newark-Norfolk	$82	$23/$35	$23/$35
Newark-Pittsburgh	123	23/35	23/35
Newark-Buffalo	99	23/35	23/35
Newark-Sarasota	159	49/69	69/99
Newark-Jacksonville	172	49/69	49/69

These low fares have not only had important benefits to travelers in the specific city pairs served by People Express, but have produced a ripple effect by spurring price reductions in many markets throughout each of the regions we serve.

People Express estimates that its service produced consumer savings totaling over $1 billion.

The combination of lower fares, innovative services and increased frequencies, have produced enormous increases in traffic, not only on People Express flights but on flights of its competitors as well. In the Buffalo-Newark/N.Y. market, for example, during the nine month period preceding People Express' entry, the Newark/New York-Buffalo O&D market totalled 341,700 passengers. During the nine months following People Express' entry, the New York/Newark-Buffalo O&D market amounted to over 622,900 O&D passengers. This represents an immediate increase of over 281,200 passengers, or over 82 percent.

Another example is the Jacksonville-Newark market, in which the total O&D market prior to People Express' entry was 34,020 (first quarter 1981) in contrast to the O&D market after People Express totalling 89,970 (third quarter 1981) for an increase of 164.5 percent. Norfolk-Newark, Sarasota-Newark and West Palm Beach-Newark, all showed similar results, producing immediate traffic increases of 224 percent, 233 percent and 208 percent, respectively. These dramatic passenger responses to People Express' low-fare service was replicated in virtually every new market it entered.

People Express' unique and innovative operational and management structure will make People Express a role model for American industry.

People Express can attribute its success to the unique operating and management structure it has adopted which has allowed it to achieve and maintain the lowest costs of any airline in the country. At an average cost level of about 5.5 cents per seat mile, People Express can afford to offer reliable, high-frequency jet service at rock-bottom prices and still make money for our employees and shareholders.

To be an effective world competitor, American businesses must be able to combine efficiency, low prices and service/product value. The products sold or services offered by American business must be produced at low cost to be price-competitive among other American industries and among industries worldwide. Those products and services must also be recognized as providing intrinsic value for the price paid. In addition, the production of the service or the product must not come at the expense of the individual employee. People Express understands the importance of and has achieved these objectives.

People Express successfully has been able to attain extremely low costs because of the unique way in which we integrate all of our employees as managers and owners of the company and because of the innovative methods in which we deploy our assets. Let me explain.

Among the Company's fundamental precepts is the belief that People Express' long-term success is dependent upon the attitude and commitment of its employees. The name "People Express" signifies the company's commitment to "people"—not only the traveling public but to all of our employees as well. The key to People Express' ability to maintain a low-cost structure is its success in cultivating dedication, high morale and productivity in its employees.

It is no exaggeration to state that we strive every minute of every hour of every day to create an environment which provides for the maximum involvement of every one of our people in the management and operation of the airline. People Express has no rigid job classifications and employs a relatively horizontal management structure. Each of our employees is a member of management; each performs several important staff and line functions, and each is given training and responsibility in several areas of the airline business. We have also created internal structures to keep our people fully informed of decisions and matters affecting the business of the company and to maintain open communications among all levels.

The important "people" structure of the company promotes an atmosphere of self-management which imbues each employee with a dedication to the company and to its success. The cross-utilization of a talented pool of people also produces very high labor productivity and low costs.

With the exception of only a handful of the senior management (less than a dozen) every employee of the company flies the line either as a pilot or flight attendant as well as performs airline management functions. For example, customer service representatives (flight attendants), when not on flight duty, work in reservations or at the check-in counters, or in marketing, accounting or personnel, or wherever their special talents can best be utilized. Similarly, when they are not flying, our flight managers (pilots) actually establish the Company's flight-duty schedules or work in aircraft scheduling, marketing, public relations, or flight training. In this way, each People Express employee is utilized in a variety of areas of our business. This structure helps insure that everyone in the company shares in and is committed to a unity of purpose.

While structures to encourage self-management and high productivity are important, they alone would not be sufficient without providing each employee economic incentives. In this connection, People Express offers each of its employees a package of generous economic benefits consisting of: (1) Competitive salaries; (2) stock purchase, stock bonus and stock option plans; and (3) profit sharing.

Every People Express employee is a stockholder of the company. When you see a People Express employee, you also see an owner of the company, and, therefore, an individual that has a very strong interest in the success of the company. An average Custom Service Manager holds $25,000 worth of People Express stock. Although People Express is a widely held public company, you might be interested to know that about ⅙ of the outstanding stock of the company is held by its employees; (this figure excludes the stock held by the senior founders of the Airline).

In the end, it is our "people" structure which is the real hallmark of People Express' success. We have developed an environment in which all of our employees are truly involved in every facet of the business and management of the Airline, and importantly, are appropriately rewarded for the fruits of their labor.

In addition to the innovations employed internally, People Express also uses unique operating techniques which are designed to reduce costs and enhance the value of the product. These include, among other: (1) On board ticketing on every flight; (2) unbundling of costs to the maximum extent (extra charges for baggage, beverages, food; no ticket counters); (3) expedited aircraft turnarounds and high aircraft utilization; (4) hub-and-spoke system feeding into Newark; (5) peak-off-peak pricing; (6) single-class, densely configured aircraft.

The kind of innovative mechanisms utilized by People Express, externally in its relationship to consumers and internally in its relationship to its employees, are the very kind of mechanisms that can and must be developed by American enterprise in order for it to be successful in a competitive world marketplace.

Congress should not enact legislation which restricts in any way pricing and/or entry flexibility.

People Express is committed to the success of deregulation and has great hopes for the ability of the airline industry to prosper in a deregulated environment. We are extremely concerned over reports that efforts may be made to re-regulate the airline industry through pricing restrictions or pricing zones because of the extent of recent airline losses. We vehemently oppose any such action. Businesses in other sectors of the American economy are not insulated from the forces of the economic business cycle, why should the airline industry? While there are many factors responsible for the financial posture of the industry today, including most importantly, the current economic recession, aircraft overcapacity, and high interest rates, one thing is absolutely certain: Deregulation is not the cause of airline industy's financial travail.

Competition is not destructive, it is beneficial. Regulation is destructive because it inhibits innovation and efficiency, tends to raise costs and, ultimately imposes indirect taxes on all consumers through unnecessarily higher fares. The fact that there is substantial low-fare competition, which some have negatively referred to as "fare wars" is not an indication of irrational or destructive behavior. Rather, low fare competition among the majors is a rational response to the fact that there is overcapacity in some sectors of the industry today and those carriers effected are attempting to obtain maximum economic return on their available assets. As a rule, management in a competitive environment will act rationally to maximize economic return for their companies. But, if carriers make foolish decisions, they should not be insulated from their mistakes by any governmental protective regime.

There is no such thing as "partial" regulation. Any effort to control pricing (even if market-entry is not restricted) will effectively suffocate the competitive market mechanism. The result will be inimical to the public interest by sacrificing the traveling public for the benefit of a few inefficient airlines. Moreover, it is premature to conclude that deregulation as not working. Not enough time has transpired to allow the flexibility provided by the Airline Deregulation Act to fully develop and flourish. Rate deregulation under the Act only just occurred a few months ago. And the slot restrictions which resulted in the aftermath of the PATCO strike seriously dampened and in some cases foreclosed, entry by new carriers and expansion by existing carriers. As slot (entry) regulation diminishes there will be an increase in new, innovative service. Congress must allow time for the marketplace to operate—as it does in virtually every other area of American industry.

The challenge of deregulation is the freedom it allows for airline mangers to be creative, to be innovative, to move forward or to remain static, to succed or to fail. We believe that our own success, and the success of other airlines that have followed us, as well as the success of existing airlines that have adapted to the new competitive marketplace, proves conclusively that deregulation was and still is a correct decision. We strongly urge you not to reverse or detain the progress of deregulation.

Thank you again for allowing me to present the views of People Express. I would be happy to answer any questions you may have.

Senator KASSEBAUM. Thank you very much. I appreciate the comments of all of you.

Mr. May, I would just like to comment on your idea of a commission. I do not know if you know that the GAO was requested to study deregulation and their report, I believe, is due in a couple of weeks.

Mr. MAY. I have seen their report. GAO has issued some sort of a report that I have seen.

Senator KASSEBAUM. I think you have seen the report that they are working on now?

Mr. MAY. There is one that came out about 2 weeks ago which was a study of deregulation, and the conclusion they reached was that part of deregulation was working and part was not. So, I think they are where we are at, that there needs to be a second look at particularly the pricing area, which is the conclusion they came up with in the GAO report that I saw.

Senator KASSEBAUM. We have heard comments, well, you mentioned the zone of reasonableness, and there has been also the distance-based-structure suggestion and I am sure both Mr. Lazurus and Mr. Pareti would not be supportive of that change, but have you looked at the differences between the two, distance based on zone of reasonableness enough to make some judgment on what this would do?

One, because this was raised yesterday, that indeed it would close out some of the smaller communities, that there be a determination that it just would not be worth it, within a certain zone, to provide service to those markets.

Mr. MAY. I concur with Mr. Lazurus. If you just had a cost-based structure and you had to live with that—particularly if you had a low-fare competition in some markets and not in the less-dense markets, you would probably be forced out of those less-dense markets in order to maintain your position in the high-density markets where you are probably having competition from a low-cost carrier. On that basis, we would probably see some exit from those type of markets.

I do not think that happens, though, with the zone of reasonableness. It seems to me that the zone of reasonableness, which, in effect, is tied to a mileage cost per the length of haul you have in that kind of market, certainly recognizes the differential in cost.

We have a cost curve, which I have on the back of my testimony which indicates that carriers like People Express' costs still fall within that 40-percent zone of reasonableness. I think what happens there is that you get away from the very steep discounts, which I think has plagued this industry and hurt the industry.

I think People Express has done a fine job and we certainly would not do anything that would keep this kind of entrants from coming in.

On the other hand, we still need to get away from the kind of pricing we had this spring. We had excellent load factors in the first 3 months of this year. The first 3 months of the year is a fairly high-peak season for most of the airlines, and yet we lost more money in that first quarter than we ever had before.

That does not indicate that excess capacity was a problem. What really happened was Pan Am came in with a rational fare for them of $99, a fill-up fare. Continental then decided to match that. The other carriers eventually joined in. You could say, well, that is not irrational either, because if we do not match, we will lose market share.

But we ended up with fares that had nothing to do with our costs, and all we were trying to do was protect our routes. In so doing, we lost $600 million. That does not make sense to me.

Now, if you have a zone of reasonableness, what that does, it puts a floor in there and keeps that kind of thing from happening. You might have the other two people here say, well, we do not think that is going to happen anymore. We have now learned our lesson. Fares are continuing to rise. We have a more rational situation in the fare structures.

If that happens, that is good, you do not really need the zone of reasonableness and the zone of reasonableness will not have an effect on that, because our fares are going to fall within that zone. What the zone does is prohibit the thing that happened the first quarter from happening again, and, hopefully, we will not need the zone.

But my own feeling is that some national carrier will come along and do the same thing. They will be in a cash-shortage position. They will decide to put in some irrational fare, the rest of the carriers will match it, and we will be back in the same situation where we were in during the first quarter. What I think we need is some definition of a floor that would keep that from happening.

Senator KASSEBAUM. How would you answer that, Mr. Pareti?

Mr. PARETI. I disagree, Senator. Let me give you an example that we have seen in our own system which, I think, proves our point.

When we first started and reduced the prices, as I mentioned, some 60 to 80 percent below the existing levels, in virtually every case the incumbent airlines matched our price. So you had, in essence, a price war at the very low level. And, in fact, you might think that it was somewhat irrational in that higher cost operators were, in turn, operating below their cost in order to be competitive with People Express.

What we have found over the course of the last 1½ to 2 years is that those very same airlines have now increased their prices to levels that are compensatory for them so that, in fact, there is a dual-pricing structure existing within the marketplace.

Their managers have, in essence, said we can operate at higher levels and design our product to be different than the People Express product. We can offer interline baggage and ticketing, we can offer through services, we can offer reservation systems that provide hotel and rent-a-car reservations, we can do all the things different than People Express, so when we sell our product to the consumer we say, "Gee, you can fly $23 on People Express, carry your bag on board and pay for a Coke or you can fly for $40 on USAir or Piedmont or whoever, but have the benefits of interline travel or a complete reservation system, and the consumer now has that choice."

They can make the choice of the $23 product or the $40 product. I think you are finding that rationalization. What has happened is, whether it was United or American, in seeing the $99 Pan Am fare, I think, overreacted to the situation and did not try to design their product to say, "Gee, we can go at $159 and still be competitive with Pan Am, offer frequency as compared to one flight a day and, therefore, have a system that is both cost based and, in fact, can be very competitive." That discipline has to exist within airline managers. I think we are finding that on our own system existing now.

Senator KASSEBAUM. There are some who say a new entrant, such as People Express, has an advantage, of course, entering into the market, but that, as the work force matures, you will lose some of the advantage and this will change some of your operating costs.

How do you address that?

Mr. PARETI. It may be a little disheartening for people to hear, but we actually feel that as we grow larger our costs will, in fact, go down. What we do is we price things on a seat-mile basis. We break every unit down to that seat.

We see it as a commodity, as Mr. Armellino has said. It is a seat flying between point A and point B. To the extent that we can produce that seat as low as possible, we can then price it at a very low rate and enjoy that margin of profitability.

So to the extent that we can continue to grow, the efficiencies we gain with our growth more than offsets the extra costs that we incur as we purchase more aircraft, as our people enjoy higher salary levels. We have found that today our costs from the first through the second quarter of this year have, in fact, decreased from 5.7 to under 5.5 cents per seat-mile as a result of such things as the 747 introduction and the 727's that we are now flying.

Senator KASSEBAUM. Several witnesses testified yesterday that this very competition and the effort to extract the greatest amount of profit, however, are causing very serious reservations about the question of safety and a decline in service.

How would you address that, Mr. Lazarus?

Mr. LAZARUS. First, at United, and I think I could speak for every other airline, we have something called a rule of three which really guides the airline.

The first of those rules is safety. That is our No. 1 priority for several reasons. Safety is not a matter to be compromised. It has no relationship to deregulation. First of all, safety is still regulated by the Federal Aviation Administration and they are not lessening their hold on regulation of safety.

Second of all, even if we had no regulation by the Government of safety, any prudent businessman in our business would regard safety as a very, very important matter to the public. If we lessened our hold on safety, is it not reasonable to assume that passengers would not be enticed to fly on our airline or Mr. May's airline or Mr. Pareti's airline? It makes absolutely no sense to say that safety has been affected by deregulation.

May I comment, Madam Chairman, on Mr. May's statement about the zone of reasonableness. First of all, there is a very fundamental question to be addressed by his proposal and indeed by Mr. Taneja's proposal earlier this morning.

Why should carrier management be protected against itself? Why are we different? Mr. Taneja insists we are different from any other business. We are not.

If my premise is correct that we are really not different than any other business, then why should we be protected against ourselves when no other business that I can think of which is not a public utility is protected against itself. It makes no sense.

Second, how is it that when the airline deregulation debate began some years ago, most carriers opposed deregulation. There were just a handful of us supporting it.

Now the situation, in dire economic circumstances, has completely reversed and there is only one carrier asking for a form of reregulation. How is it that in view of losses, all the carriers with one exception are not asking for protection against ourselves? Allow us to manage ourselves in the marketplace.

Third, contrary to what Mr. May said, the price-cutting situation has been caused by overcapacity. That is precisely what caused price cutting in markets all over the country and indeed Mr. May's airline, Republic itself, is a leader on the price-cutting side, and I would be happy to document that for you in the record.

It is absolutely true that when you have overcapacity in any business, whether it is ours or any other, you cut your price in a time of economic recession. So why is it that we should reregulate an industry in which we are now going through a transition and for the first time is beginning to see the fruits of deregulation?

Senator KASSEBAUM. I would only say that I think it is more than just one airline. I think there are also actually many consumers in the flying public who are perplexed by the fare wars, by the frustration of trying to figure out 50 different ways they can go and which one actually is going to be better.

I think it has created, for better or worse, through a certain period here a great deal of confusion, and I think that is why there is this effort on both the House and Senate side to reexamine deregulation. Five years have gone by now, and I think it is a time when we can begin to pull some figures together and begin to sort through some of the problems and some of the factors that have occurred which some have dismissed as far as the recession and the oil price increase and everything that did happen, which I think

even though they are external are bound to have an impact on any industry and certainly for one going through the throes of deregulation.

But I would like to comment on I think both Mr. Pareti's and Mr. Lazarus' comment. You mentioned the capital formation. It is interesting Aviation Daily on June 24 had a headline, "Airlines Considered Riskiest of All Industries," that the airline industry, because of its acute susceptibility to cyclical fluctuations in earnings is considered the riskiest of all industries by Standard & Poor's rating service.

It goes on to mention the capital formation and that it is now a problem although it does mention that United and American are recent examples of equity offerings and some innovative attempts to readdress this. Do you think this is a fair assessment of the situation?

Mr. LAZARUS. I will give you a flat answer. It is and it is not. We have been regarded as risky business. There is no question about that, and the bond ratings will show that.

On the other hand, the reason I say it is not a fair assessment is that you can point to virtually any carrier in the business and see that that carrier has either floated equity issues or has borrowed money in the marketplace. So that while the assessment is that we are a risky business, the plain fact is we have been able to raise money in both markets when money was needed.

That has taken place even with carriers who have been regarded as in dire financial straits.

Senator KASSEBAUM. Mr. May.

Mr. MAY. That comment, the data came out of a credit report issued by Standard and Poor's which in fact said that the industry had displayed greater risks than any industry group rated by Standard and Poor. The reason as they pointed out was basically substantial decline in earnings and substantial increase in debt-equity ratios.

To answer the question raised before, why should we have some protection. If you are going to price your product below what it costs you to produce it, who subsidizes the difference?

It either comes out of your stockholder's pocket or it comes out of the employee's pockets. I can tell you that is what is happening with the major airlines.

The reason we have been able to put these much lower fares in has partially been the major concessions we have obtained from our employee groups, coming out of the employees pockets, and the rest has come out of our stockholders' pockets.

Years ago, we all raised money by going out and selling stock and debt with the idea that the airlines were good businesses to invest it. We had substantial potential. Now what we are saying is let those major airlines which have matured go ahead and go under because they have higher costs because they are mature and let the new ones come in like People Express and replace all the old established airlines.

It is interesting to me to look at the cost curve. If you recall during the deregulation hearing, we all made a great issue about what low costs PSA and Air California had on the west coast. If you look at the costs curve in my testimony, you will notice that

PSA and Air California costs as well as New York Air costs are right up there with the rest of ours.

What happened was PSA and Air California became mature airlines and their costs are as high as anyone else's. It does not make sense to me to have a continued churning in the industry where the mature airlines go out of business because their costs mature. Then we have new airlines take their old airplanes with new employees at much lower costs and with lower fares and put more airlines out of business.

I think there is a great place for new airlines in this business, and they should find their nitch, and certainly People Express has done that and we ought to have a place for those. On the other hand, I don't think we should adopt a system that is going to destroy the major airlines like Eastern and some of those who have helped build this industry.

Senator KASSEBAUM. Have slot allocations been as much of a problem as the fare wars?

Mr. MAY. I think the slot allocation has certainly hurt us to some degree in all of our hubs. I think with that going away to some degree we should become more efficient in our hub cities.

Certainly the big airlines like ourselves that have major hubs have been hurt to some degree by the shortage of slots and their availability will be an improvement we will see over the next few months.

Senator KASSEBAUM. Will that help to stabilize the fare war?

Mr. MAY. I don't think that is going to make any difference in the fare wars because what happens, we have all developed major hubs and even though our hubs are different than say United hubs, a lot of people have the choice of which hub they go through. If the fares were low in the United Chicago hub and the TWA hub in St. Louis and high in the Minneapolis hub and the Memphis hub, where we serve, people will go through the other hubs.

So we pretty much have to match the fares in the other hubs because generally speaking the customers have the opportunity to go through any hub out there. We have to maintain pretty much the same fare levels throughout our hub systems

Mr. LAZARUS. May I speak to that please? The slot allocations have been particularly devastating to United because over 70 percent of our traffic moves through our major hub in Chicago. Because of the severe constraints in Chicago, that has been a devastating situation.

One of the reasons why slot allocations is such a difficult situation is the timing of the slots. That has torn up our banking concept.

We funnel aircraft in at a certain time and take them all out again and connect traffic. It has to have an effect on fares because you take advantage of whatever slots you can get at whatever time of day and you put in all kinds of fares to attract people to fly on airplanes on off hours.

So contrary to what Mr. May says, it has an effect on fares. It has certainly had an effect on us. I think you will see that as the slots rebuild, as the air traffic system rebuilds and as the economy rebuilds, first of all, a partial end to the confusion which you alluded to before quite correctly.

You will see the beginning of an end to the confusion in fares, and you will certainly see more stability in the marketplace. Should you rule out new entrants coming in? We think not. Should a carrier, a mature carrier, like United Airlines be protected against new entrants? Absolutely not.

If we are inefficient, if we cannot compete with a new entrant, if we cannot compete with an established carrier in our market that we have built up over 57 years then we should get out of the marketplace. We have no right to be protected, none at all.

Senator KASSEBAUM. Thank you very much. We appreciate your comments.

We are ready for the next panel. I wonder if for the sake of time at this point if Mr. Duffy and Mr. Ekedahl would mind coming together, please.

Thank you very much. It is a pleasure to welcome Captain Duffy, president of the Air Line Pilots Association, and Wayne Ekedahl, president of the Regional Airline Association.

Captain Duffy.

STATEMENTS OF HENRY A. DUFFY, PRESIDENT, AIR LINE PILOTS ASSOCIATION; AND DUANE EKEDAHL, PRESIDENT, REGIONAL AIRLINE ASSOCIATION

Mr. DUFFY. Madam Chairman, with my full testimony in the record, I would like to speak to you a little more with the candor of an airline pilot this morning rather than the formality of the president of the Air Line Pilots Association. My candor will be quite a bit different from the rosy views of the CAB and the ATA and some of the previous panelists.

Indeed, the public testimony of the ATA is at odds with the bleak picture painted by individual members of ATA when they meet in private with pilot groups seeking financial relief in the form of wage and work rule concessions. It is also in direct contradiction to the bottom-line fact that the airline industry is losing $1 billion a year.

Madam Chairman, the view of airline deregulation from the cockpit is that it is a cruel hoax on taxpayers, on vast numbers of air travelers, on the stockholders of airlines and on the people of great importance to me, the over 300,000 airline employees that have served this country very well. The employees of this industry have an unsettling suspicion that somehow, somewhere, sometime, the extreme financial difficulty of the industry will result in the reduction in the margin of safety that we demand of commercial airlines, if for no other reason than to save a few dollars.

My written testimony details many facts and figures to support my contentions. The question that airline pilots have for this subcommittee is "Why?" Why has the airline industry been subjected to all this disruption and instability?

As best we can determine, it was in pursuit of an untested and unproved economic theory. The proof is certainly not in the pudding. It is in the unemployment lines that are clogged with airline employees.

It is in the fact that deregulation has transformed a once profitable industry into one where bankruptcies, actual and threatened,

dominate the news. Deregulation's adherents point to the consumer benefits from air fare wars. Granted, fares are cheaper in some heavily traveled markets, but fares are much higher in small- to medium-sized markets; and both quantity and quality of service have been drastically cut back.

Short-haul travelers are clearly the losers. Long-haul travelers are the gainers, and a blatant fare discrimination is growing worse at the expense of middle America.

Madam Chairman, the CAB used very selective data from only 210 city pairs to show the benefits of deregulation. They missed quite a few cities. These facts of higher fares and reduced service raise a further question.

Who are the consumers who have supposedly benefited? They are the taxpayers whose personal income taxes must bear the burden of reduced corporate taxes paid by airlines. They are the taxpayers who now must pick up the tab for Federal loan guarantees provided to failed airlines. They are the taxpayers who provide the unemployment benefits and other assistance to laid-off airline employees who only a short time ago were taxpayers themselves.

National transportation policy requires the active involvement of the Federal Government, not an abdication of responsibility for decisions of literally thousands of airline executives who are barred by law from mutually discussing steps to save their industry. There is also a question of fairness.

When deregulation was passed, Congress said to airline employees, we think this is going to work and we think it will benefit airline employees as well as consumers; but in case it doesn't work, we are providing protections for those of you who might lose your jobs. There will be compensation and there will be guaranteed first-right-of-hire provisions.

Madam Chairman, the evidence is in. Deregulation has not benefited airline employees, but not one furloughed employee has received a dime in compensation. Not only has the Government adopted a policy to deprive these Americans of their livelihoods, but it has also broken a solemn statutory promise to help them.

What of the airline employees still flying? Is their safety and the safety of the passengers being jeopardized? Safety must not be compromised to fit a profit and loss statement. The pressure of competition leads to cost cutting and corner cutting. Redundancy is not inexpensive but it has been very effective in producing an enviable safety record.

Already we are seeing signs of strain in established carriers as well as new entrants. Aircraft are old and tired and should be replaced, but an industry that is losing money has difficulty borrowing money.

Exemptions and waivers to present operating and maintenance rules sought by air carriers attempting to reduce costs will reduce the margin of safety provided by existing regulations. The increase in the number of carriers has forced the FAA to use general aviation inspectors to monitor commercial air carriers. The number of mechanics and other personnel who can spot the problems before they happen has also been reduced.

New technology which we know would make flying safer is not installed because the industry does not have the cash that is

needed. Airline travel is still the safest mode of transportation, and airline safety must never be compromised to save a few pennies. I know we can all agree on that.

Madam Chairman, in the deregulated industry of today, can this subcommittee guarantee the flying public that safety will not be compromised in a cost benefit determination made by a beleaguered airline manager under extreme financial pressure? Frankly, you cannot.

Another threat to this industry, Madam Chairman, comes on January 1, 1985, the day set for the Sun to set on the CAB. If no action is forthcoming from the Congress, will the traveling public be adequately protected from anticompetitive practices such as mergers?

Will airline employees ever see the protections promised them in the Airline Deregulation Act? What agency will undertake the rigorous safety fitness tests that should protect the public from unsafe carriers?

In closing, Madam Chairman, I believe the public interest dictates that the Government have a definite role in aviation policy. I believe that the general public is in a period of blind faith in economic theories.

Public interest demands a healthy, safe, competitive airline industry as a reliable source of transportation, jobs, and contributions to the general business climate. At a minimum, we believe this will require some statutory zone of reasonableness pricing guidelines that take into account both distance and cost.

The industry needs a measure of stability as it adjusts to the deregulatory climate. Congress should take the lead by establishing a special independent commission with representation of labor to develop legislation for the Congress to consider.

It would be wrong if the Government failed to intervene and stop this great industry from committing suicide.

Thank you.

[The statement follows:]

STATEMENT OF HENRY A. DUFFY, PRESIDENT, AIR LINE PILOTS ASSOCIATION, INTERNATIONAL

Madam Chairman and members of the Subcommittee, I am Henry A. Duffy, President of the Air Line Pilots Association, International, representing 34,000 airline pilots at 45 airlines. It is indeed a pleasure for me to have the opportunity to address you in these Airline Deregulation hearings.

Today, I would like to focus on three broad substantive areas of concern for us. First, as President of a labor organization, I am extremely sensitive to anything which affects the interests of our members, and indeed the interests of all commercial airline pilots. Second, we have always prided ourselves as being the watchdog of the industry on airline safety matters. We are unyielding in our desire to insure that the highest levels of safety are maintained by all carriers. And third, we are extremely concerned about the health of air transportation in general.

What the individual carrier managements are telling labor and the picture that has been presented to this Congress by the ATA, CAB and others bear little resemblance to each other. Labor is being confronted with a constant barrage of information describing severely weakened and failing airlines who must seek contractual relief from their employee groups to survive. We have seen enough financial data on most of these airlines to know that what they are saying may not be far off the mark. However, the ATA testified on May 24th before the House of Representatives' Subcommittee on Aviation that deregulation has increased management flexibility enabling "pricing freedom to attract consumer demand, meet competition, and enhance needed revenue." The ATA went on to state that "with the upturn in the

U.S. economy, a lowering of jet fuel prices, the drop in prime interest rates, and the cost-cutting steps management has taken under deregulation, the year 1983 and beyond offer the possibility of sustained airline profitability." While airline managements may have concealed the extent of their problems caused by deregulation in their testimony before Congress, let me assure you that they have made no effort to disguise their plight in discussions with labor.

FROM REGULATION TO DEREGULATION

The deregulation debate actually began in 1975 under President Ford as "Regulatory Reform." For the record, the Air Line Pilots Association has always been supportive of the regulatory reform concept. We have never been convinced, however, of the need for the complete deregulation of air transportation. We felt both at the time the debate began in 1975 and at the time the Act was finally passed in 1978 that deregulation was more a reaction to the ultraconservative, tight regulation of the early and mid-1970's than to a legitimate public interest need. The Federal Aviation Act of 1958 provided more than enough latitude for enlightened regulation. In short, it was a good law poorly administered.

The mid-1970's mood of this country was for looser economic regulation, and this sentiment was fostered at the CAB under the stewardship of John Robson. He was succeeded by Alfred Kahn, commonly referred to as the architect of airline deregulation. As testimony to the fact that the Federal Aviation Act of 1958 provided the flexibility for more liberal regulation, Alfred Kahn had almost single-handedly deregulated the industry before the Deregulation Act was ever passed. Let us not forget that the "Peanuts Fares" and the "Super Savers" were products of regulation, not deregulation. Let us also not forget that by CAB Policy Statement 80, the Kahn Board implemented the pricing concept of the Zone of Reasonableness, or "fare window." And finally, let us not forget that during the 1976–1978 period, entry into markets became much easier, especially for carriers promising low fares. As we see it, the airline deregulation process was like a locomotive. Once it had gathered a head of steam, it could not be stopped. But the deregulators would not be denied their final prize, and they won the formal legislation they had sought.

The euphoric atmosphere surrounding the passage of the Airline Deregulation Act has given way to deeper and deeper concern for all but a few airlines. In our opinion, the industry has reached such depths that an objective review by Congress has been long overdue. We, therefore, welcome these hearings.

EMPLOYEE WELFARE

Deregulation has been observed by many of our Association members from an "up close and personal" perspective. At present, 5,136 ALPA members have been furloughed from their airlines. Five carriers whose pilots are represented by ALPA have ceased operations since deregulation. Air New England was liquidated, and Airlift, Braniff, Altair and Golden West have all filed under Chapter 11 of the Bankruptcy Code. Although employees were promised protection and compensation under the deregulation legislation, the benefits have not been forthcoming.

Maybe a slower transition to a deregulated industry would have allowed the industry structure to adjust without the tremendous disruptions that have occurred in the lives of career employees. As I'm sure you're aware, job-hopping between airlines is almost unknown in the aviation profession, particularly among the pilots. If a pilot's airline declares bankruptcy, finding a similar position at another carrier is extemely difficult. As Congress rushed headlong into the deregulation process, the very least that is owed to the displaced employees is to ensure that the employee protection programs are implemented at a faster pace.

Employee protection provisions

Airline employees were promised under the Airline Deregulation Act that they would have first right of hire at expanding airlines to ease the inevitable shifts and dislocations expected under the Act. Regulations that were supposed to be finalized within six months of the Act's passage were not forthcoming until January 1981, and were withdrawn the same month. Redrafted regulations were proposed again in September 1982, and are still not finalized. I understand that final regulations implementing the first right of hire program may be sent to Congress for review in the near future, and that will certainly be a welcome but long overdue development. Enough time has passed, and we would urge the Congress to delay no further, but to pass a resolution of approval when the regulations are submitted for review rather than allowing ninety legislative days to transpire. The impacted employees have already been kept waiting far too long.

Although compensatory employee protection provisions were also included in the Airline Deregulation Act, not a single furloughed employee has seen a dime. No regulations implementing these provisions have been proposed by this Administration and no funding has been voted by the Congress. Today we at ALPA find ourselves in an uncomfortable quandary. Lengthy and costly administrative proceedings at the CAB are about to start to determine whether that agency will certify the "qualifying dislocations" which are a prerequisite to compensation under that program. Yet, with all the very real hardships being experienced by furloughed airline employees under deregulation and the very high expenses incident to complying with the Deregulation Act's procedures, absolutely nothing appears to have been done to fund this program or to complete its implementation through regulations.

Finally, we have reached the distressing conclusion that these costly proceedings at the CAB will not be conducted fairly by the Board. As the Committee may be aware, a Board majority recently issued an order which, for the first time, would set a number of employee applications for hearing—four and one-half years after passage of the Airline Deregulation Act.

We at ALPA are bitterly disappointed in the structuring of that order and the way in which the CAB has handled this matter. We are reluctant to divert much of the Committee's time today to discussion of details. (We would be happy to supply the Committee with a copy of our recent filing at the Board describing our objections.) However, it is crystal clear that the present law requiring the Board to certify that deregulation was a major cause of a qualifying the dislocation, has become a cynical joke at the expense of airline employees. The CAB has shown itself to have too high an ideological stake in these issues, and has thrown innumerable impediments in our path including, e.g., artificial numerical thresholds and presumptions to be found nowhere in the text or legislative history of the Airline Deregulation Act. We urge that the requirement of CAB certification of deregulation-cause be striken from the law so that the promises of the Congress to airline employees in enactment of the Airline Deregulation Act will be kept, rather than being dishonored, as they are today.

Mergers and acquisitions

Without further legislative remedy, on January 1, 1985 the CAB "sunset" will result in the transfer to the Department of Justice jurisdiction over mergers and acquisitions as well as the authority to impose labor protective provisions in the public interest. That prospect gives airline employees great concern over the future of employee protection in mergers and acquisitions. Given the recent hostile treatment of this issue by an increasingly doctrinaire CAB, it has become clear that new legislative specific to this vital, job protection issue is urgently needed. Furthermore, transfer will not assure the necessary recognition of the fact that the public at large, and not just airline competitors, have a strike in proposed changes in the structure of the airline industry serving this country. That element of the present law has been given short shrift at the CAB in recent years. The public interest will surely languish completely if administered by the Department of Justice, long known for its emphasis on the theoretical rather than the practical.

AIRLINE SAFETY

Safety always has been and always will be a paramount issue for the Air Line Pilots Association. We have prided ourselves over the years as being the industry watchdog for safety. Any hint of degradation in this area causes us immediate concern. This is partly why we are so upset about the financial condition of the industry today.

Air travel is the safety mode of passenger transportation. The ATA in its May 24, 1983 testimony before the House of Representatives' Subcommittee on Aviation pointed with pride to the fact that during the 26-month period from October 1979 to January 1982 there was not one single fatality in turbojet aircraft operations. We are proud of that accomplishment too.

This excellent and prolonged overall level of safety is not a coincidence. It also did not occur simply because of Federal Aviation Administration (FAA) established minimums that apply to all carriers. In our view, the industry's exemplary safety record has occurred because of a great deal of hard work and an unswerving commitment by the airlines and their employees. In short, an "additional margin"of safety has been developed in this industry by exceeding, not just meeting, FAA minimums. This "additional margin of safety" is the result of fully equipped training facilites and maintenance centers, safety programs, reliable aircraft and respon-

sible work rules. Our labor agreements have been built with this as the linchpin of aviation safety.

These are the not so subtle reasons for our safety record. An often overlooked one, however, has been the overall economic stability of the industry. The basic infrastructure for airline safety was fostered by this structural environment. Economics and safety cannot be separated.

As I will point out later in my testimony, the airline industry under deregulation has consistently degenerated to the point of acute financial anemia. And, we see signs that the margin of safety we have carefully nurtured, and cherished so much, is indeed decreasing.

The U.S. Senate is on record as saying:

"It should be unnecessary to point out that a profitable operation is necessary for safety. It is bad enough for ordinary corporations to be harassed by losses, but in the case of an air vehicle, when safety depends on expensive equipment, there must be ample funds or the ships must be grounded."

The U.S. Senate Committee on Commerce said this 46 years ago on March 27, 1937 when Congress was considering regulation of a chaotic, unprofitable, essentially deregulated aviation industry.

In his March 1, 1983 testimony before the U.S. Senate Transportation Appropriations Subcommittee, James Danaher, Director of the National Transportation Safety Board's Bureau of Technology, raised a similar warning flag. He said that commuters have a "tendency to overlook and short circuit" federal safety provisions. He further stated that for those carriers experiencing financial difficulties, safety provisions would be most vulnerable to cutting corners. Regardless of whether an airline is a Major, a National, a large regional or a small commuter, the same link between economics and safety exists.

We see some black clouds on the horizon as the current air carrier financial distress squeezes our safety margin. First, the 26-month fatality-free period referenced with pride by the ATA abruptly came to a halt in January 1982. In the subsequent 12-month period, there were five fatal air carrier accidents, with a total of 236 deaths. Two of these fatal crashes (involving Air Florida and World Airways) have been associated with deregulation by organizations other than ALPA.

Now let's look at a few recent examples of corner-cutting of FAA safety minimums:

On March 5, 1982, a financially strapped Air Pennsylvania abruptly shut itself down before the FAA and CAB could move in and formally cite the carrier for violations. The FAA had planned some $18,000 in fines for over 30 safety violations.

Aeroamerica was grounded in 1982 by the FAA for operating a non-airworthy B-720.

On February 17, 1983, the FAA fined 18-month-old Guy-America Airlines $50,000 and forced its president to resign, after finding various safety infractions that "tended to lead to a pattern of non-compliance." The FAA continued its report by saying,

"They established a pattern and an attitude at the top management level that we could no longer live with."

All of the airlines cited above were operating on a shoestring and were in financial difficulty. Morever, under deregulation, the number of air carriers has increased to the point where the FAA now has to use general aviation inspectors to monitor FAR Part 121 air carriers. Putting the two together, I have serious concerns about the maintenance of the historically wide margin of safety under deregulation.

Small carriers in the deregulation environment pose a very difficult problem for those of us seeking to maintain and hopefully enlarge our margin of safety. A recently published MIT doctoral dissertation[1] noted that:

"There were approximately 62 commuters which had been reporting continuous passenger service to the CAB from 1976. Of those 62, 10 ceased operation, either due to bankrupty or liquidation in 1981. However, for the other 100 or more commuters which offered service during 1981, the turnover appears to be in the 35 percent to 40 percent range, since 39 terminated in 1981.

"The base 52 commuters still operating at the end of 1981 from 1976 carried over 55 percent of all 1981 commuter passengers and should have sufficient resources to be able to finance modest expansion. The remaining 100 commuters with their high turnover are the carriers that create finanical problems for investors."

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[1] James Molloy, "Policy Alternatives for the U.S. Commuter Airline Industry After Four Years of Deregulation," Mass., May 1983.

If any link can be established between financial distress and safety degradation, the bottom 100 constantly recycling commuter carriers referenced above certainly look like prime examples of this relationship. With four out of every ten expected to cease operations each and every year, the potential for disaster under the structure created by Congress in 1978 should be obvious.

Instead of actively pursuing the highest degree of safety, it appears to us that, both in the name of and as a result of deregulation, our safety cushion has become somewhat deflated. The government has allowed this to happen. For example, the CAB was given a safety role by the Deregulation Act, but has essentially employed a rubber-stamp fitness test for new entrants, relying on the FAA as a backstop. The proliferation of new carriers judged fit by the CAB, has, as already stated, exacerbated the FAA's safety inspection manpower problem. As you may already know, ALPA filed suit in the U.S. Court of Appeals to enforce this statute. Unfortunately for us, and the traveling public, we lost this battle. We wonder if safety will decline even more when the CAB sunsets in a year and one-half.

AIRLINE INDUSTRY HEALTH

Now I would like to focus on the industry's health. One of the most popular rallying points for deregulation proponents is the bargains some air travelers have received at the ticket counter since 1978. Virtually everyone would agree that fares, on an aggregate basis, are probable lower than they otherwise would have been under strict regulation. Proof positive of this statement is the persistent and suicidal fare wars of which we are all aware.

Now let's look at the other side of the coin. Somebody ultimately has to pay for these so-called low-fare consumer benefits. I submit to you that while the consumers of air transportation in the high-density, long-haul and certain other markets have been enjoying price windfalls tantamount to a gluttonous free lunch, the producers of air travel have been picking up the very large tab. Since 1978, the producers of air transportation have heavily subsidized certain classes of air travelers. Those producers most immediately affected are airline employees, airline stockholders and airline lenders. Other secondary, but no less affected, producers are the airports, the airframe manufacturers, the aircraft engine manufacturers and related aviation industries. The federal government has also been subsidizing these air travelers. And, there is one final group which has also contributed heavily—the airline consumer in the short-haul, low-density markets.

We have already presented information regarding the impact of deregulation on our membership. For the record, I would like to state the bottom line again—15 percent of ALPA's membership is on furlough. In addition, airline labor as a whole, through some combination of permanently lost jobs, interrupted employment, pay cuts, pay deferrals, fringe benefit reductions and work rule changes, has paid a high price under deregulation. The industry call for efficiency has not fallen on deaf ears, but the song and dance from airline managements is starting to sound off-key. Let me illustrate.

The all too familiar scenario goes like this. The leadership of a pilot group is called into the chief executive officer's suite for a "frank discussion" of that airline's condition. Once there, it is presented with detailed information of how the carrier simply cannot make it without help from its employees. And since the pilots are the most highly paid they must provide the leadership for the rest of the employees. In many cases, our pilots have been quite willing to provide this form of assistance to their carriers. If, however, the pilot group is unreceptive to the CEO's pleas for help, he starts playing "hardball" by threatening to furlough a substantial number of pilots and resize the airline. If they doesn't work, a complete shutdown through Chapter 11 bankruptcy proceedings is threatended. This may sound melodramatic, but let me assure you that this exact progression of events actually occurred at a long-established carrier in 1983. This tactic is usually arranged to coincide with a timely visit from one of the airline's friendly bankers. Faced with these options, our pilots have generally agreed to management's demands. When one employee group has given in, management goes after the others.

Now, what does an airline do with the millions of dollars it extracts from its employees?

It cuts its fares.

So do its competitors. They they go to their employees for matching concessions.

And, quickly these carriers are right back where they started, except with less of a revenue base than before.

I have seen this scenario replayed over and over again. It is our opinion that some carriers who may not even need help from their employees, are asking for it anyway because they don't want to miss out on the opportunity while it is there.

In the scenario I have just described, the airline employee has been heavily subsidizing certain airline travelers. But, in my judgment, he won't do this forever. The Machinist's union has already drawn a line, and I see signs almost daily now of our membership reaching in its pockets, not for more money to give away, but for its own piece of chalk to draw its line. There is a time bomb ticking in the industrial relations arena. Sonner or later, airline executives are going to have to learn that labor concessions are not a panacea for ineffective yield management.

Now I would like to address the fuel issue. Since 1973, the airline industry has moaned and groaned about escalating fuel prices. And indeed, they have been a problem. In 1973, they accounted for about 12 percent of operating expenses; now they comprise one-third. Both fuel and labor became the convenient whipping boys for the industry. Labor still is, but you don't hear very much about fuel these days.

Why?

Because fuel alone could have been the industry's salvation.

Fuel price decreases and labor concessions could have turned overall deregulation losses into profits. But they didn't. Airline management has allowed the price breaks on fuel to vanish just as it did with reduced labor costs.

How?

By lowering fares every time they got a fuel price break.

Table 1 shows that in May 1981, the airlines paid an average of $1.076 per gallon of fuel. Through April 1983, the price had dropped 17.2 cents to an average of 90.4 cents per gallon. In 1981, the industry saved $161 million because of declines in the price of fuel. For 1982 alone the figure was $900 million. And, in just four months of 1983, the industry realized a $449 million gain. The combined figure for the 23-month period in question is $1.51 billion. And the airlines still lost money!

Now let's discuss briefly how deregulation has contributed to the federal deficit. It may surprise this committee but the federal government has also subsidized the fare war beneficiary, and in general received little benefit itself from deregulation. Pricing under deregulation has affected every taxpayer in the country, through the largess of the government. As shown in Table 2, in the years 1973–1978, the U.S. Government received nearly $1 billion in tax revenues from the major and national carriers. Since deregulation, the government has yet to receive any net tax revenues from the major and national carriers and will not in the foreseeable future. The obvious question is where has all this money gone? The answer is that the carriers have again squandered these monies through destructive price wars. Consequently, potential tax revenues which could have been applied to the federal deficit have instead been used to subsidize the $99 airline ticket.

Recognizing the desperate need of the airlines to modernize their fleets, the government extended generous tax credits to assist the airlines in re-equipping. Without safe harbor leasing benefits of $445 million in 1982 and $465 million in 1983, the airlines would not have been able to proceed with plans to purchase more fuel efficient aircraft. Because low fares have drained earning power from the carriers, the taxpayers as a whole have had to bear the burden of providing the airlines with the means to purchase new aircraft. How can taxing all citizens for this purpose be considered more equitable than having consumers of air travel pay for the aircraft in the price of their tickets?

Through its loan guaranteee program, the federal government has also lost money to carriers who have defaulted on their comments. Airline loan guarantee programs began with the Government Guarantee Loan Program in 1957. From that point in time to 1978, this program had guaranteed over $300 million in loans to 20 carriers for 149 aircraft. Not one carrier ever defaulted on a loan under this program. The FAA has been forced to ask for $45 million in Fiscal 1983 supplemental budget requests to cover defaults by three carriers, and $250 million in Fiscal 1984 to cover defaults by a number of other carriers now at risk. The taxpayers will pick up the check for this, and be thankful that the FAA has decided to conclude the aircraft guarantee program.

Now, let's examine how the investment community and the financial institutions have been the victims of deregulation. Let's first look at the equity side of the issue. In the Majors, Nationals, and Large Regional category, only 21 percent have shown a bottom-line profit every year since 1978 (Northwest, US Air, Alaska, Frontier, Piedmont, PSA, Southwest, Transamerica, Air Wisconsin, Rosenbalm and Reeve). Conversely, the same percentage—21 percent—never turned a bottom-line profit (Braniff, Continental, Republic, United, Airlift, Altair, Golden Gate, Jet America, New York Air, Northeastern and Pacific Express). During the 1973–1976 period of

true regulation, however, 34 percent of the airlines in the same category earned profits consistently, and when they lost money, their losses were not nearly so deep as they have been under deregulation. Only two carriers never earned a profit (Modern, and Western Alaska) during the 1973–1976 period.

When companies consistently lose money, their net worth (equity) declines. Airlines are no exception. Some airlines like Southwest, People Express, USAir and Piedmont have recorded significant increases in stockholder equity since 1978. But, for the overwhelming majority of airline stockholders, deregulation has produced a serious net worth drain. Tables 3 and 4 show the industry's net worth in both current and 1967 dollars since 1973. As you can see, the industry has been in steady decline on a real basis since 1978. Table 5 shows how debt as a percent of equity has climbed since 1978. Despite the remarkable ability of the airline industry to attract equity capital in 1982 and so far in 1983, the airline industry stockholder has heavily subsidized certain classes of airline consumers since 1978.

And, what about the debt side of the ledger? In large measure, it is the financial institutions (namely the banks) that have provided the necessary funds to the industry for equipment purchases and other necessary activities (including survival). This group has subsidized the airline consumer in a very subtle, but critical manner. The banks have provided needed cash (through revolving credit arrangements) to help individual carriers through tough times. They have also assisted many airlines by waiving loan covenants that technically could have forced those carriers into bankruptcy. Of course, since the airlines' overall credit ratings have declined as their earnings have declined, they are now paying the banks dearly for the privilege of staying alive. In some cases, the financial community has allowed the airlines to miss principal payments on loans, and at Braniff even interest and principal payments were forgiven for a period of time. But probably most importantly, the banking industry has so far refused to pull the plug on many carriers it easily could have. It is virtually impossible to put a dollar value on the amount of subsidization the financial institutions have provided to the beneficiaries of fare wars. But we all know the figure must be substantial.

Now let's examine the aerospace industry. With the airlines consistently losing money, and debt-to-equity ratios already averaging 2 to 1, the financial predicament of the nation's airlines has an effect on equipment purchase decisions. This, in turn, impacts the commercial side of the aerospace business. Table 6 presents selected quotes from the Boeing, McDonnell Douglas and Lockheed SEC 10–K and/or annual reports each year since 1978. Clearly, the commercial aviation fortunes of these companies have changed since 1978. it has been widely known for some time that airlines tend to make large equipment orders when times are good and take delivery of these aircraft when times are bad. Chart 1 shows this relationship.

But this time around, under deregulation and its resultant fare wars, the situation is much worse. Table 7 shows initial orders of various aircraft types since 1973. As you can see, 1978 was banner year. But when Table 8 is examined, you can clearly see that the financial condition of many carriers became so severe by 1980 that they were forced to cancel outright their orders for many aircraft, and forfeit considerable equipment deposits in the process. Thus, deregulation has hurt the airline industry and the aerospace industry alike.

What I have just discussed is a short-term effect of deregulation. The greater danger is that this will become a long-term reality, and as the airline industry deteriorates, it will substantially weaken the aerospace industry in the process. Although the major focus of these hearings is the airline industry, let us not forget what the International Trade Commission recently stated in its Publication 1340:

"The commercial aircraft industry contributes a larger positive trade balance than any other U.S. industry except agriculture. During the last 10 years, the industry has produced a surplus of about $35 billion for the United States."

Information we have obtained from the U.S. Department of Commerce shows that there have been $31.5 billion in commercial aircraft sales since 1978. These figures are contained in Table 9. This industry has far-reaching economic implications for this country, and it appears that so far it has not benefited from airline deregulation.

Another group subsidizing the low-fare airline consumer is the airline consumer not traveling in markets where low fares abound. These travelers tend to be concentrated in small and medium size communities. We have strong reason to believe, after sampling fares in a cross section of markets by traffic density and distance, that the low to medium density, short to medium haul traveler is cross subsidizing the high density, long haul traveler just as the long haul markets cross subsidized the short haul markets under regulation. But, a major objective of deregulation was

to eliminate all forms of this activity. We feel that this is a critical area for complete research and continued scrutiny.

Dr. Nawal Taneja of MIT, in his June 15, 1983 testimony before the House of Representatives' Subcommittee on Aviation of the public Works Committee, stated that despite a reduction in the quality of service in small communities, the fares paid by consumers in these markets have ". . . increased at a rate more than twice the system-wide average rate of increase." To illustrate further the decline in the quality of service, specific states can be cited:

In Senator Exon's home state of Nebraska, departures in Essential Air Service Communities have dropped 53.9 percent since deregulation. The number of seats offered in these markets has likewise dropped off by 34.5 percent. The number of nonstop destinations has declined from 42 to 29 and the number of single-plane multistop destinations from EAS points has fallen from 64 to 38.

In Oregon, of interest I'm sure to Senator Packwood, departures at EAS points have increased 14.6 percent but available seats have declined 24.9 percent. The number of nonstop destinations from EAS points has dropped from 28 to 15 and single-plane multistop destinations have been reduced from 31 to 27.

Senator Ford may know that in Kentucky available seats from EAS points have declined 61.3 percent. Departures have increased slightly by 6.8 percent, but nonstop destinations are down to 8 from 13, and multistop single-plane service is way off, with only 9 destinations remaining of 20 at the start of deregulation.

In Missouri, available seats are down 27.6 percent even though departures are up 16.5 percent at EAS cities. Senator Danforth is I'm sure interested in the drop in nonstop destinations from 30 to 24, and in the decline in single-plane multistop destinations from 42 to 29.

The December 1982 CAB study entitled "Competition and the Airlines, an Evaluation of Deregulation" attempts to address this issue, but uses only departures to measure it. In the study, the CAB (which is loaded with deregulation ideological bias) stated:

"Overall service to small communities has declined slightly, but the sub-groups of communities have been affected very differently."

In an attempt to cast deregulation in a more favorable light, the CAB in the next chapter of its study, addressed the convenience of air service issue. The study concluded:

"The simulations show that convenience has increased slightly in the hub market categories and declined slightly in the non hub categories."

This was the result of: ". . . a total of 210 markets . . . selected for the analysis."

The CAB study claims to have "randomly" selected these markets. The Committee should be aware that there are well over 100,000 markets in this country from which the Board had data readily available. But it "randomly" selected only 210. I strongly suspect that instead of "randomly" selecting the markets in its study, the CAB in fact "very carefully" selected markets which would show the Board's already predetermined conclusions. In any case, a 210 market sample proves very little. For the record, we disagree with many other conclusions of that study, but will not focus on them today.

Another study commonly cited to indicate that service to small communities has improved as a consequence of deregulation is the National Economic Research Associates' study by Gary Dorman. This study uses an even smaller sample, only 50 cities, and measures the travel time to an arbitrarily assigned "regional center" and back to measure the adequacy of small community service. This issue is far too important to be decided on the basis of incomplete analysis. We would welcome a comprehensive, objective study utilizing an extremely large sample of markets.

Lastly, a recent GAO study released May 18, 1983 concluded that: ". . . the number of passengers using air service at the 88 subsidized communities decreased by 50 percent since deregulation began in 1978. Unless the communities make progress toward achieving self-sustaining service, carriers are likely to abandon or substantially reduce service to most of the subsidized small communities when the program ends in 1988."

A final group which seems to have been given a short straw by deregulation is the airports in small communities. According to CAB data, there were 660 airports in the continental U.S. at the end of 1982. Of that total, 540 (81.8 percent) were in the non-hub category and 62 (9.4 percent) were in the small hub category. These small hub and non-hub categories comprise 91.2 percent of the airports in this country. Table 10 shows that, as a group, small and non-hub airports had 5.6 percent fewer departures in December 1982 than in December, 1978. Non-hub airports alone experienced a net decline of 10.3 percent. Moreover, when available seats were compared, the situation was even more pronounced. There was a 12.6 percent decrease

in available seats at both small and non-hub airports combined, and a 21.7 percent overall decline in seats at the 540 non-hub airports alone.

I realize that the 23 large hub airports account for about half of the departures and over 60 percent of the available seats in this country, but in the name of deregulation should we allow this vital sector of our society to deteriorate? And finally, what happens to these airports and communities in 1988 when the Essential Air Service Program dies?

CONCLUSIONS

Unlike the deregulation purists, we feel very strongly that the industry's financial doldrums are not a short-run, business cycle related phenomenon. On the contrary, we feel they are structural in nature, and left unattended the industry will continue to report below average or negative earnings, be plagued with persistent overcapacity, experience an abnormally high bankruptcy rate, suffer a decline in safety and generally be tormented with chronic instability. Nineteen Section 401 certificated carriers have ceased operations because of financial problems since deregulation.

Now these are strong words to describe something many of you have supported. Airline deregulation was a supreme effort by reasonable and prudent individuals to let the free market determine the quantity, quality and price of air transportation. And, there have been some benefits for some people. But at what cost? This is where we and the avid deregulation proponents differ. We simply feel the pendulum was allowed to swing too far in the other direction. In our opinion, what is needed is a mid-course correction, characterized by some guidelines which preserve the spirit of deregulation but will allow this industry to survive and prosper.

Clearly, deregulation has been good to only a few airlines, even though the egos of many airline presidents prevent them from acknowledging this fact. In his heart, each CEO I am certain believes he will be the survivor in this senseless war of attrition. Chart 2 shows vividly that the industry reached its operating profit zenith just as the Airline Deregulation Act was being passed by Congress. Since that time, it has been all downhill. Many observers blithely explain this away as a result of OPEC, PATCO and the recent recession. Certainly they have hurt the airlines, but what about deregulation? Is it completely blameless? I submit that deregulation has had a far greater impact than these other events.

Tables 11 and 12 show Net Income After Tax data for the industry for the 10-year period 1973–1982 in current and constant dollars, respectively. I think we can safely say the 1979–1982 period can be used to portray the airlines under deregulation. As explained previously, 1977 and 1978 can best be characterized as years of de facto deregulation under a regulatory framework. The 1973–1976 period would best be described as a period under traditional regulation.

Now let's examine the 1973–1976 and 1979–1982 periods in more detail. During both periods, the industry experienced OPEC oil embargos that caused severe fuel shortages and skyrocketing fuel costs. Also during both periods, the nation experienced a deep recession.

So what was the difference? In the 1973–1976 period we had regulation and in the 1979–1982 period we had deregulation and PATCO. The PATCO strike did not occur until August 1981. Thus, we can easily compare the effects under regulation and deregulation.

In the 1973–1976 period combined, the airline industry rated more than $1 billion compared with a $750 million loss in the 1979–1982 period. (Using constant dollar figures the relationships are the same.) From this we have deduced that the PATCO strike and deregulation potentially cost the industry as much as $1.75 billion. We have further deduced that the troughs of earnings in this industry today are far more pronounced than they ever were under regulation. Unfortunately we can't say anything about the peaks since the industry has been in a continual slide since the end of 1978. Charts 3 and 4 show this relationship very vividly. The shaded areas in both graphs are much larger under deregulation than they were in the 1973–1976 period when there was some discipline governing the actions of the industry.

It also appears that ALPA is not alone in its assessment regarding the inherent instability deregulation has brought to the airline industry. In a recent report by Merrill Lynch, the following statement was made:

"At the end of last year when we discussed the urgent need for this industry to take advantage of the recent market window for equity financing, we took the position—extreme though it may be—that any airline not achieving a one to one debt to equity relationship at the peak of the current economic cycle becomes an automatic candidate for severe financial difficulties, if not bankruptcy, in the subsequent (inevitable) recession."

The report continued with a discussion of debt to capital ratios and specifically broke down 16 airlines into three tiers. In the top tier at the end of 1982 with debt to capital ratios below 50 percent (debt to equity ratios below 1:1) were, Northwest, Southwest, Ozark, Delta and USAir. In the less desirable second tier with debt to capital ratios between 51 and 67 percent (debt to equity ratios between 1:1 and 2:1) were Frontier, Piedmont, American, UAL, Inc., Trans World and PSA. And in the least desirable category with debt to capital ratios over 68 percent (debt to equity ratios over 2:1) were Pan Am, Eastern, Western, Continental and Republic. Next, the report stated:

"In our view, companies whose debt is now no more than two thirds of total capital probably have a very realistic opportunity to achieve our 50 percent standard before the cycle peaks. However. the five carriers in the bottom tier are perhaps more likely to find that debt is still over 60 percent of capital at the peak of the cycle, and this may not be good enough to survive the ravages of the next recession, which we believe will produce net losses at least as large as those recently experienced, and probably larger."

The above statements were indeed remarkable for a company that has a vested interest in selling common stocks and would normally be expected to have very bullish tendencies.

In short, the authors of this Merrill Lynch report seem to have all but written off Pan Am (our most widely known carrier worldwide), Eastern (which enplanes more passengers than any other airline in the free world), Western and Continental (very important carriers in the Western half of the U.S) and Republic (a large carrier connecting many cities throughout this country). In our opinion, if the Merrill Lynch prediction were to come true, our air transportation system would suffer irrevocable harm. Surely this is not what Congress intended when it passed the Deregulation Act in 1978.

The report continues with a discussion of the necessity for the airlines to re-equip their fleets with new-generation, fuel-efficient aircraft during the very same period of time the carriers should be concentrating on balance sheet improvement. Aside from the obvious implications for the carriers, the outlook for our aerospace industry appears similarly ominous. If there are several bankruptcies or near bankruptcies either now or in a few years the result is the same—fewer and fewer new aircraft orders, and if airline bankruptcies occur, an exacerbated overcapacity problem which will further depress earnings and equipment orders.

But our industry is not dead yet.

And, with some guidelines to protect the industry from itself, it will indeed survive and prosper.

We would like to offer this Committee our suggestions on how we can solidify the industry's revenue base, and thereby achieve a level of stability which will benefit this nation as a whole.

At a minimum, we believe this will require some statutory "zone of reasonableness" pricing guidelines that take into account both distance and cost. The industry needs a measure of stability as it adjusts to the deregulatroy climate. Congress should take the lead by establishing a special, independent commission—with representation of labor—to develop legislation for the Congress to consider.

It would be wrong if the government failed to intervene to stop this great industry from committing suicide.

Before concluding my statement, I would like to make brief reference to some unresolved CAB Sunset issues although they are not the focus of this committee. Without further legislative remedy, the following consequences of Deregulation and Sunset will occur on January 1, 1985:

(1) Authority will be lost to strike down "predatory" pricing and other anti-competitive practices in domestic markets. Under present law, authority to police such practices domestically will sunset on January 1, 1985, without transfer to any other agency (including the FTC). Loss of central policy direction on competitive issues in the same expert agency which has the regulatory responsibility, would be a significant loss indeed, even if the present flabby posture of the CAB on pricing issues has resulted in relative disuse of this authority.

(2) The statutory premises will be lost for various consumer protection regulations governing domestic air transportation (baggage rules, denied boarding, smoking, charter tour operators' bonding and escrow, prohibitions againse deceptive advertising and other "unfair or deceptive practices or unfair methods of competition"). If responsibility for protection of the domestic flying public is spread among the several states, not only will such protections be substantially weakened—to the ultimate detriment of the reputation of this industry—but a multiplicity of potentially conflicting rules and laws will place a heavy burden on the airlines.

(3) New legislation is needed to continue the collection of data concerning carriers which operate interstate and overseas. Data now collected by the CAB on its Form 41 serve a variety of very important uses, and the need for these data will continue long after the Board is scheduled to go out of existence. Already, these data have given the Federal government and other students of the airline industry the information necessary to evaluate the progress of deregulation. The small community air service programs, as well as an international route and rate regulation which will remain, cannot function without adequate data.

(4) Finally, the separate certification of air carriers for domestic air transportation with an attendant, separate fitness determination over and above that provided by the FAA will be lost. While we are not satisfied with the present efforts of the CAB in screening the fitness of new applicants—a number of applicants with very poor records have been certified—a new agency with a fresh mandate would do better if given firm direction by the Congress. As mentioned previously, the FAA's efforts are demonstrably inadequate. Furthermore, the FAA, unlike CAB, provides no forum in which third parties may present evidence and participate.

Madam Chairman, this concludes my statement today. I will be happy to answer any questions your committee might have.

Attachments.

TABLE 1.—AIRLINE INDUSTRY FUEL SAVINGS, MAY 1981–APRIL 1983—CERTIFICATED U.S CARRIERS

	Fuel consumption (thousands of gallons)	Actual cost per gallon (cents)	Difference in cents from peak 107.6/ gallon cost in May 1981	Estimated monthly cost savings	Estimated annual cost savings
May 1981	895,421	107.6			
June 1981	942.966	106.4	1.2	$11,315,592	
July 1981	998.177	105.4	2.2	21,959,894	
August 1981	899,162	105.5	2.1	18,882,402	
September 1981	845,376	104.6	2.7	22,825,152	
October 1981	871,349	104.5	3.1	27,011,819	
November 1981	812,785	104.2	3.4	27,634,690	
December 1981	872,077	104.0	3.6	31,394,772	$161,024,321
January 1982	870,843	103.76	3.84	33,440,371	
February 1982	785,368	103.25	4.35	34,163,508	
March 1982	880,719	101.72	5.88	51,786,277	
April 1982	848,401	99.11	8.49	72,029,245	
May 1982	853,336	97.68	9.92	84,650,931	
June 1982	876,015	97.66	9.94	87,075,891	
July 1982	940,283	97.53	10.07	94,686,498	
August 1982	946,818	97.23	10.37	98,185,027	
September 1982	857,211	96.95	10.65	91,292,972	
October 1982	865,250	97.54	10.06	87.044,150	
November 1982	809,534	97.87	9.73	78,767,658	
December 1982	857,252	97.41	10.19	87,353,979	900,476,507
January 1983	847,683	96.79	10.81	91,634,532	
February 1983	[1] 742,564	95.60	12.00	89,107,680	
March 1983	[1] 833,219	92.62	14.98	124,816,206	
April 1983	[1] 835,070	90.4	17.2	143,632,040	449,190,458
				1,510,691,286	1,510,691,286

[1] Date imcomplete.

Source: CAB form 41, I. P. Sharp database.

TABLE 2.—EFFECTIVE TAX RATES, MAJORS AND NATIONALS, 1973–82

	Combined income before taxes	Taxes	Effective tax rate(in percent)
1973	$364,660,835	$124,479,748	34
1974	498,339,826	215,788,970	43
1975	−73,053,133	−25,885,768	0

TABLE 2.—EFFECTIVE TAX RATES, MAJORS AND NATIONALS, 1973–82—Continued

	Combined income before taxes	Taxes	Effective tax rate(in percent)
1976	608,509,623	168,883,976	28
1977	941,433,296	234,446,587	25
1978	1,428,246,625	236,077,944	16.5
1979	161,116,881	−181,642,878	0
1980	−170,780,182	−104,892,403	0
1981	−646,563,205	−153,257,081	0
1982	−987,211,071	−112,390,540	0

Source: CAB form 41, schedule P–1, I. P. Sharp Database, ALPA Economic Analysis and Information SErvices Department.

TABLE 3.—NET WORTH, U.S. AIRLINES, 1973–82

Year	Industry	Majors	Nationals
1973	$4,606,119,248	$3,991,803,589	$214,117,982
1974	4,655,212,810	4,203,474,209	388,709,860
1975	4,551,143,072	4,039,373,962	448,863,763
1976	5,054,887,080	4,459,841,047	538,580,018
1977	5,927,649,898	5,304,430,902	614,243,489
1978	7,091,248,207	6,403,837,851	674,163,132
1979	7,662,391,790	6,688,511,416	935,211,677
1980	7,599,840,275	6,464,206,440	1,072,486,467
1981	7,739,735,164	6,084,770,819	1,492,938,858
1982	7,277,942,026	5,480,618,380	1,573,880,479

Source: CAB form 41, schedule B1, I. P. Sharp Database, ALPA Economic Analysis and Information Services Department.

TABLE 4.—NET WORTH, U.S. AIRLINES, 1973–82

[In 1967 dollars]

Year	Industry	Majors	Nationals
1973	$3,460,645,566	$2,999,101,119	$160,870,009
1974	3,151,802,850	2,845,954.102	263,175,261
1975	2,823,289,747	2,505,815,113	278,451,466
1976	2,964,743,155	2,615,742,550	315,882,709
1977	3,265,922,809	2,922,551,461	338,426,165
1978	3,629,093,248	3,277,296,751	345,016,956
1979	3,524,559,241	3,076,592,188	430,180,164
1980	3,079,351,813	2,619,208,444	434,556,915
1981	2,841,312,468	2,233,763,149	548,068,597
1982	2,517,447,951	1,895,751,774	544,406,945

Source: CAB form 41, schedule B1, I. P. Sharp Database, ALPA Economic Analysis and Information Services Department.

TABLE 5.—DEBT AS A PERCENT OF EQUITY, U.S. AIRLINES, 1978–82

Year	Industry	Majors	Nationals
1978	109.3	105.1	142.7
1979	130.2	121.4	184.2
1980	157.3	144.9	208.4
1981	169.3	165.3	175.0
1982	195.6	197.1	187.9

Source: CAB form 41, schedule B1, I. P. Sharp Database, ALPA Economic Analysis and Information Services Department.

TABLE 6.—SELECTED QUALITATIVE STATEMENTS OF GENERAL BUSINESS CONDITIONS MADE BY U.S. AEROSPACE COMPANIES, 1978–82

Year	Boeing	McDonnell Douglas	Lockheed
1978	During 1978, announced new orders for the Company's commercial transports totaled 490 aircraft which represented 67 percent of all new free world commercial jet transport orders and 63 percent of all free world dollars committed to such airplanes for the year.	Firm orders for 66 DC–9's were received in 1978, an increase of 29 percent over same number as in 1977. Firm orders for 43 DC–10's were received in 1978, an increase of 48 percent over 1977.	Particularly gratifying were the sign-ups of orders for new and follow-on business, topped by nearly two billion dollars' worth of business on missiles and space programs. The 30 new firm orders on our L–1011 TriStar commercial transport program added more than a billion dollars to the TriStar backlog, and the number of TriStar option orders outstanding increased by 26.
1979	During 1979, announced new orders for the Company's commercial transports totaled 317 aircraft which represented 54 percent of all new free world commercial jet transport orders and 48 percent of all free world dollars committed to such airplanes for the year.	Firm orders for 49 DC–9's were received in 1979, a decrease from the 66 aircraft ordered in 1978. This decline reflected a general slackening in demand for new aircraft. Firm orders for 34 DC–10's were received in 1979, a decrease from the 43 aircraft ordered in 1978, due in part to the Chicago crash of 25 May and subsequent, temporary grounding of the DC–10's.	The TriStar market continued strong in 1979, equaling the previous year's pace of new orders. With a two-year backlog of firm orders, we believe that we are in good position to accommodate the uncertainties now facing the commercial airline market.
1980	During 1980, announced new orders for the Company's commercial transports totaled 361 aircraft which represented 78 percent of all new free world commercial jet transport orders and 74 percent of all free world dollars committed to such airplanes for the year.	Firm orders for 12 DC–10's were received in 1980, a decrease from the 34 aircraft ordered in 1979, as general economic conditions worsened and the airline industry incurred substantial losses.	1980 was a year of successes and disappointments. Although we made progress and achieved good profits on most of our programs, we also experienced additional excess production costs on the L–1011 program. The write-off of these costs along with higher interest costs resulted in disappointing earnings . . . earnings which were far less than we had planned.
1981	During 1981, announced new orders for the Company's commercial transports totaled 224 aircraft which represented 64 percent of all new free world commercial jet transport orders and 57 percent of all free world dollars committed to such airplanes for the year. In late February, 1982 American Airlines announced that by reason of inadequate profits and a discouraging industry outlook it had discontinued its plan to purchase 15 757s.	Firm orders for 17 DC–9's were received in 1981, compared to 20 in 1980. Firm orders for three DC–10's were received in 1981, a decrease from the 12 aircraft ordered in 1980. There were no firm orders for DC–10's to be delivered in 1983.	After considerable evaluation and deliberation we decided on December 7 to phase out production of the L–1011 TriStar commercial jetliner. This decision was made only after we became convinced that there was little likelihood of achieving economic production levels in the forseeable future. Generally unstable market conditions for commercial aircraft and the financial consequences of attempting to sustain production at low levels in anticipation of a market upturn left us no other logical choice. It was with considerable regret that we found it necessary to phase out the program.

TABLE 6.—SELECTED QUALITATIVE STATEMENTS OF GENERAL BUSINESS CONDITIONS MADE BY U.S. AEROSPACE COMPANIES, 1978–82—Continued

Year	Boeing	McDonnell Douglas	Lockheed
1982	During 1982, announced new orders for the Company's commercial jet transports represented 49 percent of all free-world commercial jet transport new orders and 48 percent of all free-world dollars committed to such airplanes for the year.	Firm orders for 49 DC–9's were received in 1982, compared to 15 in 1981, and agreements were consummated to lease an additional 35 DC–9's to two airlines. No firm orders were received for DC–10's in 1982, compared to three orders in 1981.	(No L–1011 program).

Source: Sec. 10–K reports and company annual reports.

CHART 1

INITIAL AIRCRAFT ORDERS AND NET INCOME AFTER TAXES U.S. AIRLINES 1973 - 1982

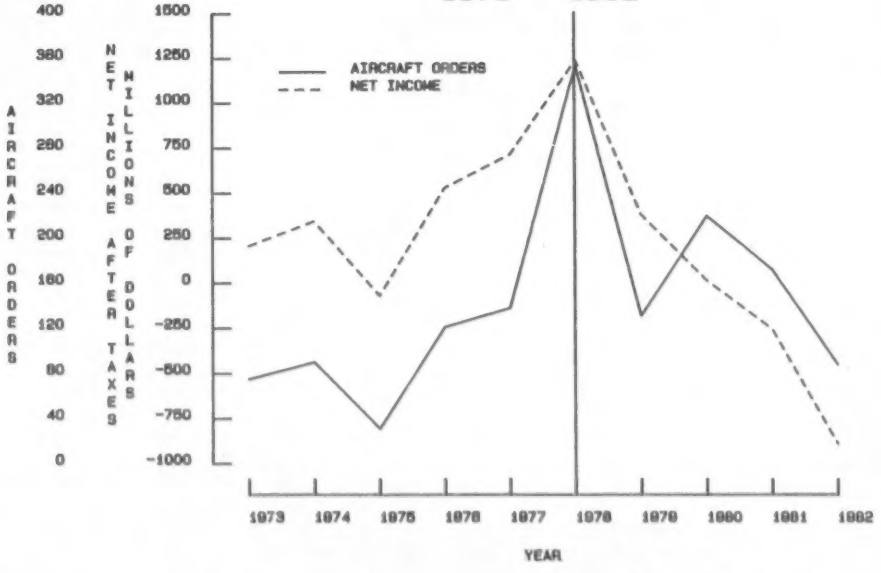


TABLE 7.—INITIAL AIRCRAFT ORDERS, U.S. AIRLINES, 1973–82

Aircraft type	Aircraft orders by year									
	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
A–300	0	0	0	0	0	23	0	0	9	0
B–727	44	59	25	94	87	87	61	49	30	5
B–737	3	3	2	6	18	42	20	35	72	44
B–747	13	3	0	2	4	25	8	0	0	0
B–757	0	0	0	0	0	21	0	69	18	0
B–767	0	0	0	0	0	80	0	27	0	0
DC–9	5	19	4	13	14	38	24	32	28	39

TABLE 7.—INITIAL AIRCRAFT ORDERS, U.S. AIRLINES, 1973–82—Continued

Aircraft type	Aircraft orders by year									
	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
DC–10	9	0	0	3	12	18	9	0	0	0
F–28	1	0	0	0	0	0	5	0	12	0
L–1011	0	6	0	3	3	20	4	8	3	0
Total	75	90	31	121	138	354	131	220	172	88

Source: SEC 10–K reports, annual reports, Avmark. ALPA Economic Analysis and Information Services Department.

TABLE 8.—CANCELLATIONS OF AIRCRAFT ORDERS, U.S. AIRLINES, 1973–82

Aircraft type	Aircraft order cancellations by year									
	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
B–727	0	6	0	0	0	0	3	20	13	0
B–737	0	0	0	0	0	6	0	4	2	6
B–747	0	5	0	1	0	0	1	1	0	5
B–757	0	0	0	0	0	0	0	0	3	15
DC–9	0	0	1	0	0	7	4	5	1	4
DC–10	1	0	3	0	0	1	0	0	0	0
F–28	0	0	0	0	0	0	1	0	0	4
L–1011	0	0	0	3	0	0	0	1	0	0
Total	1	11	4	4	0	14	9	31	19	34

Source: SEC 10–K forms, annual reports, Avmark. ALPA Economic Analysis and Information Services Department.

Table 9.—International sales of U.S. civilian aircraft, 1978–82

[In billions]

1978	$3.6
1979	6.2
1980	8.3
1981	8.6
1982	4.8
1978–82	31.5

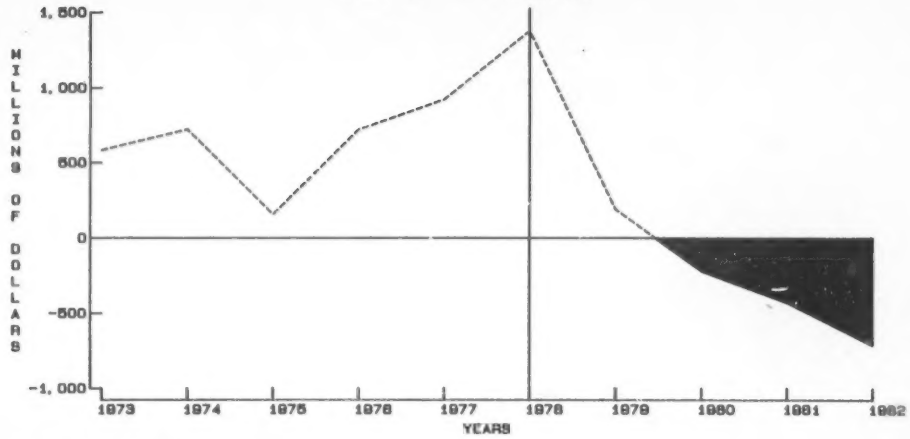
Source: U.S. Department of Commerce, Office of Trade Analysis.

TABLE 10.—AIRCRAFT DEPARTURES AND AVAILABLE SEATS AT AIR TRAFFIC HUBS, DECEMBER 1978–DECEMBER 1982

Hub class	Number of communities	Weekly departures		Weekly available seats	
		December 1978	December 1982	December 1978	December 1982
Large	23	62,222	66,766	6,927,963	7,812,346
Medium	35	23,858	26,367	2,289,039	2,465,008
Small	62	14,103	14,692	1,192,469	1,143,262
Nonhub	540	29,427	26,396	1,106,009	866,289
Total	660	129,610	134,221	11,515,480	12,286,905

Source: "Report on Airline Service, Fares, Traffic, Load Factors, and Market Shares," Civil Aeronautics Board, March 1983.

CHART 2
OPERATING PROFIT
(CURRENT DOLLARS)
U.S. AIRLINES
1973 - 1982



SOURCE: CAB FORM 41
I.P. SHARP DATABASE
ALPA ECONOMIC ANALYSIS AND INFORMATION SERVICES DEPARTMENT

TABLE 11.—NET INCOME AFTER TAXES, U.S. AIRLINES, 1973–82

Year	Industry	Majors	Nationals
1973	$207,614,001	$176,408,989	$60,638,629
1974	344,688,430	276,898,415	64,343,934
1975	−69,650,476	−107,548,925	39,338,401
1976	530,462,035	474,462,865	62,207,407
1977	715,549,811	635,594,498	87,760,770
1978	1,240,270,709	1,138,146,610	92,750,207
1979	380,836,167	259,141,090	113,490,225
1980	14,198,505	−20,865,067	64,906,158
1981	−255,011,814	−364,842,268	164,939,982
1982	−889,594,122	−782,942,854	−59,124,741
1973–76	1,013,113,990	820,221,344	226,528,371
1979–82	−749,571,264	−909,509,099	284,211,624

Source: CAB form 41, schedule P1, I. P. Sharp Database, ALPA Economic Analysis and Information Services Department.

TABLE 12.—NET INCOME AFTER TAXES, U.S. AIRLINES, 1973–82

[In 1967 dollars]

Year	Industry	Majors	Nationals
1973	$155,983,472	$132,538,684	$45,558,699
1974	233,370,636	187,473,538	43,563,936
1975	−43,207,491	−66,717,695	24,403,475
1976	311,121,428	278,277,340	36,485,283
1977	394,242,320	350,189,806	48,353,041
1978	534,734,242	582,470,118	47,466,841
1979	175,177,630	119,200,133	52,203,415
1980	5,753,041	−8,454,241	26,299,092

TABLE 12.—NET INCOME AFTER TAXES, U.S. AIRLINES, 1973–82—Continued

[In 1967 dollars]

Year	Industry	Majors	Nationals
1981	−93,616,672	−133,936,222	60,550,654
1982	−307,711,561	−270,820,773	−20,451,311
1973–76	657,268,045	531,571,867	150,011,393
1979–82	−220,397,562	−294,011,103	118,601,850

Source: CAB form 41, schedule P1, I. P. Sharp Database, ALPA Economic Analysis and Information Services Department.

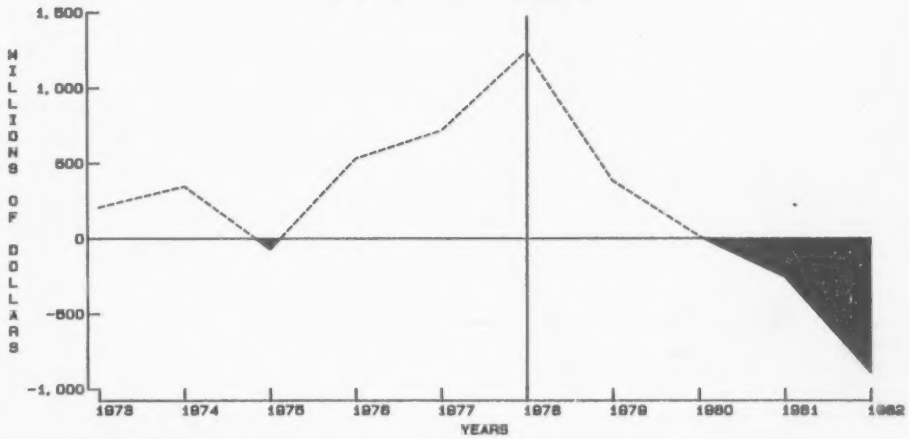
CHART 3

NET INCOME AFTER TAXES

(CURRENT DOLLARS)

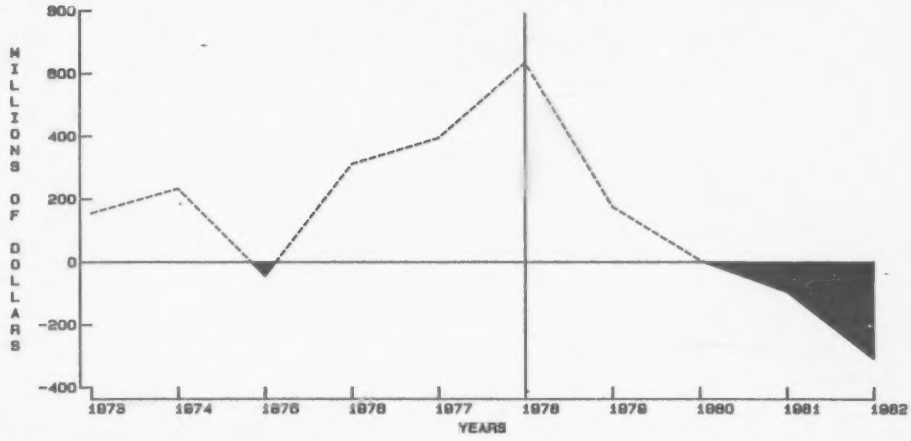
U.S. AIRLINES

1973 - 1982



SOURCE: CAB FORM 41
I.P. SHARP DATABASE
ALPA ECONOMIC ANALYSIS AND INFORMATION SERVICES DEPARTMENT

CHART 4
NET INCOME AFTER TAXES
(CONSTANT 1967 DOLLARS)
U.S. AIRLINES
1973 - 1982



SOURCE: CAB FORM 41
I.P. SHARP DATABASE
ALPA ECONOMIC ANALYSIS AND INFORMATION SERVICES DEPARTMENT

QUESTIONS OF SENATOR HOLLINGS AND THE ANSWERS THERETO

Question. Mr. Duffy, you adovcate that Congress establish a "zone of reasonableness" for airlines fares. Why can we not expect the airlines to initiate this on their own, in their long-run self-interest?

Answer. The Air Line Pilots Association does not believe that the airlines can initiate and maintain rational pricing on their own for several reasons. Deregulation enabled the glut in the used aircraft market, which enabled inexpensive entry into the airline business for new carriers, to result in serious overcapacity in the industry. This excess capacity has been the root problem behind drastic price-cutting and fare wars among airlines.

In addition, airline travel as a product exhibits many of the elements found in a commodity. The airlines have been unable for the most part to produce meaningful product differentiation, so carriers can only compete in terms of frequency and price. Competition by increasing frequency of service only exacerbates the overcapacity problem, exerting downward pressure on prices. Price is by far the deciding factor used by the public in deciding on which airline to fly.

Efforts by individual carriers to alleviate the devastating effects of price discounting have not been successful. For example, not long after American initiated a fare formula based on costs and distance, Pan Am cut coach fares 17 to 53 percent on April 15. The airlines have not been able to get a handle on the pricing situation. As long as there are carriers in need of cash and willing to price below their true costs there will be suicidal price wars.

Question. You have also discussed the importance of safety with regard to deregulation, citing recent accidents that have occurred as evidence of a growing problem. Has your analysis indicated to you the extent of the problem? In other words, do you see a general degradation of safety throughout the industry? If so, please cite specific examples for the record.

Answer. ALPA did not cite testimony tying deregulation with the degradation of safety. The statements you may be referring to may be attributable to the following quote: "two fatal crashes involving Air Floria and World Airways have been associated with deregualtion by associations other than ALPA."

In spite of the fact that we cannot cite specific accidents resulting from deregulation, our concern is that since our industry is suffering from adverse economic con-

ditions there exists a potential for cost cutting measures within the industry to affect the overall margin of safety that presently exists within the industry. It is the actions taken by individual airlines which exceeded the minimum FAA safety standards that has given us the fine safety record we have enjoyed in the past. However, without a positive economic outlook, airlines might not be able to take actions which consistently exceed the minimum safety standards required by FAA. Therefore, the overall margin of safety is reduced. In other words, we do see a potential degradation of safety throughout the industry, although we are not able to point to specific examples resulting from this degradation tied directly to deregulation.

Question. In their testimony, the Association of Flight Attendants testified that many airlines offer incentive programs to flight attendants for on-time departures. Are their similar programs offered to pilots? If so, do you believe that these incentive programs have in any way hindered airline safety?

Answer. We are not aware of any incentive programs offered to pilots for on-time departures.

Question. Your prepared statement touches upon the deteriorating service to small communities and the inability of the Essential Air Service program to provide the necessary incentives for developing small community air service. Do you have any suggestions for the Committee today as to how we can improve the EAS program, in order to better ensure such service?

Answer. While I have no specific suggestions to offer to improve the EAS program, I can indicate to you several areas which seem central to the problems being experienced by small communities. The CAB has allowed abandonment at nonhub points to occur very rapidly, just as the CAB has accelerated deregulation in other areas. The ten year program for small communities has for all intents and purposes been turned into a four year program. Small communities have not had time to review their situation and plan for change, just as the airlines have not been able to make a gradual transition. In addition, the "bumping" provisions which became effective January 1, 1983 allow any carrier receiving subsidy to be replaced by another carrier at the end of two years. This further penalizes carriers serving EAS points and increases instability.

Without efforts to foster gradual transition and stability in air service, change can only mean disruption and loss of service to consumers in these markets. I am concerned that air travel is becoming increasingly centralized at major hubs and in dense markets. While this may be economically more efficient, it leaves rural America out of the infrastructure on which future economic development will be based.

Senator KASSEBAUM. Mr. May, of course, mentioned the Commission, too. It seems to me we are having to decide everything in Government now by commission. We cannot seem to be able to hold hearings such as this and come up with some of our own thoughts regarding the importance of these issues.

Mr. Ekedahl, why don't you go ahead and then we will ask questions.

Mr. EKEDAHL. Thank you. I am Duane Ekedahl, president of the Regional Airline Association. With me is Tulinda Deegan, vice president of Government relations. We are very happy to be here today. With your permission I will set my formal testimony aside and very briefly summarize the points made.

Senator KASSEBAUM. It will be included in full.

Mr. EKEDAHL. Thank you.

We think it is appropriate to look at the performance of the regional air carriers because, as you know, when the act passed Congress, a special role was envisioned for regional commuter carriers. Many at that time questioned whether the small airlines would be able to provide the replacement service necessary if the majors abandoned the small markets in a massive way.

Many questioned whether the public would accept small air carriers replacing large jet service. Many questioned whether these small carriers would have the financial wherewithal to grow to

meet the demands placed on them, and indeed many questioned whether it would be a safe system.

So in reflecting back over the 4 years since passage of the act, it is interesting to note that the industry has grown some 80 percent in passenger enplanements in that time. It has grown to serve over 800 airports.

The regional air carriers provide the only service at two-thirds of those points at a time when the number of points served by the major carriers has declined. Industry has doubled the capacity of its aircraft fleet during that 4-year period, suggesting that the financial capability was there.

Perhaps the most encouraging thing is that the safety record of this industry during this growth period dramatically improved to a point where, as the Congress had envisioned, an equivalent level of safety with the major carriers was achieved. Indeed, all of this was accomplished in a very cost effective way from the standpoint of the taxpayers. With the transition from 406 to 419 subsidy, the cost was reduced in half.

So in looking back, one would conclude that the regional air carriers have indeed met the demands placed upon them and have contributed to any success coming from airline deregulation. I would like to conclude by a statement of the future as we examine the status of deregulation.

The success that the small carriers have in providing service in small communities depends on one very important thing, access to the primary hub airports. The people in these communities find smaller carriers a suitable replacement for the reluctant major carrier if the frequency is improved and the timing of the connections is proper.

So we are naturally concerned about increased capacity at the hub airports and whether or not the small carriers will be excluded from those airports. The building of airport capacity, is in our view one of the high priorities we face as an industry.

One suggestion that is advanced for addressing capacity problems is of very great concern to us. That is the suggestion of tossing it open to the highest bidder, the auctioning off of air space. Obviously we see ourselves losing out in that scenario and that there are very, very serious long-term problems.

The difficulty with this suggestion, when scheduling committees and others come to deadlock, is that it is simple and it has the appeal of being the "forces of the market place" at work. It all sounds very good, but we would like to leave with you a thought that nothing would unravel the pattern of small community service that has been vital to the success of deregulation quicker than to toss access at hub airports up to the highest bidder as an alternative to the scheduling committees and other forms of allocating that access.

That basically concludes my statement this morning, Madam Chairman. Thank you.

[The statement follows:]

STATEMENT OF DUANE H. EKEDAHL, PRESIDENT, REGIONAL AIRLINE ASSOCIATION

Madam Chairman, it my pleasure to present testimony on behalf of the Regional Airline Association. I am Duane H. Ekedahl, President of the Regional Airline Asso-

ciation. With me today are Tulinda Deegan, RAA Vice President of Government Relations and Alan Stephen, RAA Vice President of Operations.

The Airline Deregulation Act of 1978 was the first major revision in the economic regulation of the airline industry in twenty years. One of the purposes of the Act was to allow the major and national airlines to withdraw from communities that had proven to be uneconomic.

The Airline Deregulation Act relied upon the regional/commuter airline industry to replace the national and major airlines in the less profitable communities so that these airlines would be freed to enter other markets.

The regional airline industry has stepped forward and more than adequately filled the role designed for them in the Airline Deregulation Act of 1978. The backbone of the Act is the small community air service program. A strong small community air service program guarantees that the entry and exit provisions of the Act are successfully implemented.

At the time of the debate on airline deregulation there were several concerns raised as to the ability of the regional/commuter airline industry to take over air service to the nation's small communities. I would like to review these concerns and provide a status report on the progress the regional/commuter airlines have made in the five years since the passage of the deregulation act.

ESSENTIAL AIR SERVICE

The first concern was the ability of the regional/commuter airline to step up and replace the national and major airlines. In 1982, the regional airline industry carried over 18 million passengers, a 80 percent increase since the Deregulation Act was passed in 1978. Regional air carriers flew to over 800 communities in 1982—a 58 percent increase since 1978. Today, 92 percent all communities receiving scheduled air service are served by at least one regional airline. At two-thirds, or 561 communities, regional airlines provide the only scheduled airline service.

Over the same period, the major airlines have continued to reduce the number of communities they serve to a record low in 1982 of 283 communities.

The following table shows the 1978 versus 1982 traffic statistics for the regional airline industry.

REGIONAL/COMMUTER AIRLINE RESULTS 1978 VERSUS 1982

	1978	1982	Percent change
Carriers operating	258	245	−5
O&D passengers (millions)	10.1	18.55	+84
Total airports served in North America:			
By regional/commuters	630	817	+30
By majors/nationals	673	323	−52
Percentage of total airports receiving scheduled air service:			
Regional/commuters (percent)	69	92	
Majors/nationals (percent)	80	36	
Airports exclusively served:			
By regional/commuters	359	566	+58
By majors/nationals	230	49	−79

Replacing the major and national airlines is not new for the regional/communter airline industry. The first official replacement agreement was in 1968 when Henson Aviation replaced Allegheny at Hagerstown, Maryland. Many of the markets that are now served by regional/commuter airlines are enjoying higher frequency service with aircraft that is better suited for the traffic requirements of the communities.

Since the new essential air service program, the number of Essential Air Service points served by regional/commuter airlines has increased by 62 percent, while the points served by the national and major airlines have decreased by 55 percent. In real numbers, the regional/commuter airline are serving over 300 communities in the essential air service program.

SERVICE TO ESSENTIAL AIR SERVICE COMMUNITIES

	1978	1982	Percent change
Points eligible	320	327	
Points served by:			
Exclusively regionals/commuters	83	220	+106
Exclusively majors/nationals	133	23	−83
Jointly served	104	84	−20
Total EAS points served by:			
Regionals/commuters	187	304	+62
Majors/nationals	237	107	−55

A complete list of the essential air service communities, their CAB determinations, and the air service that the community is currently receiving is attached to our testimony.[1]

SUBSIDY COST

The cost of providing essential air service under the Section 419 program has been less than the historic Section 406 program. Section 419 is based upon the needs of the individual communities, while the Section 406 program was based upon the system need of the airline providing the small community air service.

The CAB has made 56 subsidy determinations at a cost of $24,811,543. The following table provides a historic review and comparison of the two subsidy programs.

COMPARISON OF SUBSIDY PAYMENTS SECTION 406 VERSUS SECTION 419

[In thousands of dollars]

Year	Section 406 subsidy	Section 419 subsidy
1950	35.0	
1976	72.5	
1977	82.2	
1978	73.9	
1979	72.1	0.5
1980	80.1	9.0
1981	106.7	15.0
1982	55.1	26.0
1983	13.5	39.8
1984	0	50.8

Notes:
Section 406 of the Federal Aviation Act. Includes local service operations, Alaska operations, Air New England, and Air Midwest.
Section 419 of the Federal Aviation Act—"Small Community Air Service Guaranteed Essential Air Transportation."
While section 406 expired Jan. 1, 1983, Congress appropriated a special fund to be equally distributed to the former recipients of the Section 406 Subsidy.
The figures for 1983 and 1984 are estimated presented in the "Budget of the United States Government—Fiscal Year 1984."

SUFFICIENT AIRCRAFT AVAILABLE

During the debate on airline deregulation the issue of aircraft availability was raised. The fleet of the regional/commuter airline industry has increased by 50 percent to over 1,500 aircraft in just five years. Over 250 turbo-prop aircraft have been added to the fleet.

The hours flown by the aircraft used by the regional/commuter industry has increased by almost 100 percent to meet the needs of small community air service.

Aircraft in regional airline passenger service, 1978 versus 1982

Aircraft in active fleet:	
1978	1,047
1982	1,573
Percent change	+50

[1] The list has been retained in the committee files.

Hours flown (thousands):

1978	1,131
1982	2,160
Percent change	+91

Recently, there have been hearings and discussions on whether foreign government export practices have created an unfair and anti-competitive market environment for U.S. airplane manufacturers. The Regional Airline Association beleives that there should be clear distinction on federal policy between fostering a healthy U.S. aircraft manufacturing industry and maintaining a healthy domestic airline industry under deregulation.

The RAA is committed to pursuing a policy that maintains an open and competitive sales climate for the purchase of light transport aircraft in the United States, one that does not inhibit the certification, product support, sales or terms of financing of aircraft by building "protectionist" barriers.

SAFETY RECORD

Another concern was safety. There were several FAA, NTSB, and Congressional Hearings focusing on the safety record of the industry after the passage of the act.

In 1982, the regional/commuter airline industry had fewer fatal accidents and fewer fatalities than the major and national airlines. In the five years since the passage of the act, the industry has demonstrated an equivalent level of safety as the national and major airlines. The implementation of the upgraded Federal Air Regulations and the new industry sponsored safety programs have led to the outstanding safety record of the industry.

FINANCIAL STABILITY OF THE INDUSTRY

Of the 245 airlines in the regional/commuter sector of the airline industry, only a handful are publicly held. According to RAA's records only 12 carriers report their financial results. Of the 12, the largest carrier had gross revenue of $50 million in 1982. The smallest grossed some $4 million. As a group, the 12 publicly held carriers generated $250 million in revenues producing a net profit of $11.4 million. This equates to an overall profit margin of 4.5 percent. While this may seem to be a relatively small profit margin, RAA finds it to be respectable when compared to the massive losses faced by the major and national airlines and the difficult economic environment facing the entire airline industry.

As for the financial results of the rest of the 233 regionals, little financial information is available. This lack of information, due to the nature of private ownership, makes it difficult to assess the success or failure of the regional airline industry as a whole.

The press has covered the failures in the industry, while very little has or can be written about the financial successes regional/commuter industry.

JOINT FARES

The Airline Deregulation Act of 1978 included the regional/commuter airlines in the uniform system of combining two or more air fares when the passenger uses the service of more than one airline. In other words, for the first time regional/commuter airlines were placed on equal footing with the larger airlines in offering joint fares to the travelling public. The joint fare system helped the regional airlines replace and develop the communities abandoned by the majors and nationals.

On January 1, 1983 joint fares were terminated when the Civil Aeronautics Board lost the authority to regulate air fares. Since that time the uniform system of joint fares has changed radically. The number and types of joint fares offered by the majors and nationals varies widely, making it difficult to generalize the result of the end of the uniform system of joint fares construction and division of revenue.

The full impact of the termination of joint fares will not be felt until the new joint fares tariff book is issued by the Airline Tariff Publishing Company.

REGIONAL/COMMUTER AIRLINES HAVE MET THE CHALLENGE

From the above discussion it is clear that the regional/commuter airline industry has stepped forward to meet the challenges of the new role designed for them by deregulation.

Thank you for the opportunity to present the views of the Regional Airline Association on the status of deregulation. Ms. Deegan, Mr. Stephen, and I are prepared to answer any questions from your committee.

QUESTIONS OF SENATOR HOLLINGS AND THE ANSWERS THERETO

Question. While you stated in your testimony that the number of Essential Air Service points served by regional air carriers has increased by 62 percent, would you characterize the program a success in terms of promoting long-term service for those communities?

Answer. The Regional Airline Association will be submitting extensive testimony on the Essential Air Service program at the Committee's fall hearings that will be dedicated to the evaluation of the small community air service program since deregulation.

The key to a stable long-term air service pattern for a small community is the use of aircraft properly sized to the traffic needs of that community. Historically, the local service carriers provided small community air service under the Section 406 subsidy program. This subsidy program encouraged the carriers to maximize subsidy payments rather than maximize the service to the communities that they served. The more money a local service carrier lost in providing service to a community the more subsidy the carrier received from the federal government. Therefore, many communities were receiving air service with jet aircraft that was not suited to the air traffic generated by that community.

The Section 419 program is based upon the needs of the community rather than the needs of the air carrier providing the air service. The Section 419 program encourages the use of aircraft properly sized for the traffic needs of each small community.

Question. What recommendations can you give the Committee in terms of improving upon the Essential Air Service program?

Answer. The Regional Airline Association would recommend that the Committee carefully evaluate the essential air servic program in 1988 when the program expires.

QUESTIONS OF SENATOR RIEGLE AND THE ANSWERS THERETO

Question. Major airlines with large aircraft have abandoned small communities for potentially larger major hub to major hub markets. While the replacement aircraft have to be sized to the market to reduce or eliminate subsidies, opposite extremes have often been the result. What can be done to provide minimum capability aircraft by replacement carriers which would include pressurization, toilet facilities (especially on longer flight segments), better handicapped person accessibility and consideration for cargo needs, even though the aircraft may be smaller?

Answer. The introduction of the new generation turbo-prop aircraft is the single most exciting new development in the Regional Airline industry. Since 1979, no fewer that 16 different models of turbine-powered light transport aircraft seating from 9 to 70 passengers have either been put into production or are under development. The airframe manufacturers are producing new aircraft that are specifically designed for the needs of the regional/commuter airlines. This new generation of aircraft is designed with maximum passenger comfort for short-haul flights. The Regional Airline industry will have a wide choice of "consumer" designed aircraft to economically and fuel effficiently serve the needs of small communities.

Recently, there have been hearings and discussions on whether foreign government export practices have created an unfair and anti-competitive market environment for U.S. aircraft manufactures. The Regional Airline Association has been concerned with the attempts by certain U.S. small plane manufactures to "link" the domestic sales of light transport aircraft manufactured overseas and destined for use by the U.S. regional/commuter airline industry, as a bargaining chip in the sales of U.S. general aviation aircraft abroad. Trade barriers that inhibit the sales of foreign built aircraft to the regional/commuter airline industry, would prevent the exciting new generation aircraft from being introduced to serve the needs of the small communities.

The Regional Airline Association believes that there should be a clear distinction on federal policy between fostering a healthy U.S. aircraft manufacturing industry and maintaining a healthy small community air service program under deregulation.

Question. Losses due to fare wars on major routes have in many cases resulted in increased fare costs to rural passengers attempting to get to hub cities. This results in forcing passengers to drive to hubs, depresses small community air passenger loads further and increases subsidy requirements at Essential Air Service locations. What can be done to resolve this disparity?

Answer. While the deep discount fares have forced many passengers to drive to major hubs to take advantage of the low fares, the fare wars have also generated a new breed of joint fares called "add-on" fares. Add-ons are a set dollar amount that are be added on from the small community or feeder route to the major's or national's discount fare.

The Regional Airline Association believes the problems associated with the recent fare wars cannot be addressed by any additional regulation. The economy of the entire country must improve before the industry pricing structure can be rationalized.

Question. Due to the air traffic controllers strike, restrictions have been placed on the aviation industry through the center and major slot program. Center slot requirements are being phased out throughout this year. However, major airport slot and flow control requirements will continue. It is not healthy to restrict the growth of any industry and this is the end result of slot requirements. Until capacity is increased, maximum productivity of available airspace with equal access to all is a must. This raises several questions.

(*a*) What immediate short term and long term alternatives can be pursued to provide unrestricted capacity at major hubs?

(*b*) Until restrictions can be eliminated, how can available slots be fairly allocated?

(1) Is first come, first served, the best policy?

(2) Should slots be sold to carriers with the risk of major carriers gaining a monopoly?

(3) Should slots be allocated by lottery?

(4) Should slots be allocated by priority ranking such as EAS replacement carriers first, new carrier service second, expanding carrier service third, etc.?

(5) Should slots that remain unused for a designated period of time be required to be returned to the pool or sold?

(6) Can slots be sold to another carrier at any time?

Answer. The Regional Airline Association Board of Directors and the Government Relations Committee discussed the status of the air traffic system at their last regular meeting. The joint meeting reviewed the current procedures being used to handle air traffic since the PATCO strike and the recent FAA proposals. The Board of Directors passed the following resolution as a recommendation for improving the air traffic system:

"Resolve that, the Regional Airline Association oppose any continued FAA control over the freedom of airlines to schedule by the imposition of a permanent system of controlled delays such as Quota Flow or assigning Arrival/Departure times as a means of contolling access to the national aviation system. The Board further directs that the RAA should urge the FAA to:

"(1) Develop procedures in consultation with the airlines serving capacity constrained airports to minimize congestion and delay;

"(2) Rely to the maximum extent possible on the airlines to develop voluntary guidelines maximum airport access;

"(3) Recognize that equal flow control assigned delays inordinately impact short haul operations;

"(4) Develop low altitude procedures and separate access to secondary runways such that Regional airlines do not have to use the same Airspace/Runways as jet operations and therefore do not have to share in the same delays;

"(5) Discourage scheduling practices such as unreasonable "banking" that cause delay and congestion for other carriers making reasonable use of that airport."

"(6) The Regional Airline Association is very concerned by the recent discussions to offer for sale the right of access at the nation's airports. Such a system would seriously damage the current air transportation system.

Question. Past practice permitted major carriers who were providing their own feeder service from smaller communities to maintain reasonable fares through subsidies and absorbing some loss, if necessary on feeder routes to assure long route and total system profitability. After deregulation, the major airlines abandoned the feeder routes, subsidies have been reduced and mandatory joint fares eliminated. How can reasonable service and access to service be preserved for this public utility which is essential to the economic survival of lower density areas?

Answer. Reasonable and economic service from the nation's small communities will be preserved by the use of aircraft properly sized for the traffic needs of each community. Air service will be stable when the traffic generated from a community produces enough revenue to prove economic for a airline to provide service.

Senator KASSEBAUM. Thank you very much, Mr. Ekedahl.

I would like to go, Captain Duffy, to the question of safety. Mr. Ekedahl, you mentioned you thought the safety record had been very good. We heard quite a bit about safety yesterday.

I guess I would have to agree somewhat with the prior panel that it is in the best interest of the company to see that safety factors were maintained at the highest level, but yesterday a witness from the machinists union testified that the flight engineers or pilots that have been responsible for checking were as a matter of fact taking less care with their preflight check, and due to deregulation and the thrust toward the competitive efforts that were necessary there to keep ahead of their competition, they were sacrificing many of these requirements due to time, due to the need to get off the ground.

I would like to ask you if you believe this is happening. These are standards that the FAA has imposed that need to be met. Do you see that there is in any way a violation of those requirements?

Mr. DUFFY. Of course the machinists would know better the jobs that the actual mechanics are performing. I can give you the cockpit view of it, and that is, that there has been no diminution of responsibility for the walkarounds, let's say. Every pilot walks around his airplane. That goes back to the Wright brothers.

On every airline, there is a differing of procedures as to what things should be looked at and by whom, the mechanic or by the pilot. But I suspect that there are no pilots who don't walk around their airplanes.

Senator KASSEBAUM. You do not think this has become rather cursory and is not being given the attention it should?

Mr. DUFFY. Not having heard what he said yesterday, if they are pressured as far as being cut back on manpower or speeded up or that kind of thing, we would be very concerned about that. The only time it gets to us is when we have to change planes fast and we get off one airplane and run over to the other, and we have to make a quicker walkaround. But I don't think anyone eliminates the procedure.

Senator KASSEBAUM. You mentioned the labor protection provisions and the guarantees that were there at the time the ADA was passed. I know that has been a concern. It has been a concern to those of us here who want to see a fair resolution to those promises that were made there to those who lost their jobs because of deregulation.

This is something that as you know we place a top priority on here, and it does need to be resolved. It needs to be resolved as soon as possible, particularly in light of the fact that we are facing decisions regarding the Civil Aeronautics Board that must be met soon. We will have hearings in September on the Civil Aeronautics Board one more time to see indeed what package we can put together at this point in time.

It is something that I can assure you I am dedicated to helping resolve. I am sure Senator Exon is as well and other members of this committee.

I have been troubled by the implication both yesterday and in your testimony that safety and service have been jeopardized by deregulation. As I say it would seem to me that would only place, particularly in a very competitive atmosphere, the companies in some jeopardy, far more than they would be if they were protected and regulated because they have a record to uphold.

Mr. DUFFY. Let me say I don't think any manager starts out making the decision that ends up in an accident, but I also do not think any managers in the airline business are any different than the managers in any other business. That is, they rationalize and they make cost benefit decisions.

If they can rationalize the fact that they put off the purchase of a piece of equipment or the replacement of a piece of equipment or a maintenance procedure for another day or another week or another month, they do not necessarily make that decision in contemplation of an accident.

But we know that accidents usually result from a long chain of events. If any one of the links of that chain had been removed, the accident would not have happened.

We know what the safety of this industry was built on. That was a substantial margin above what the FAA requires. It is made up of good training departments, good maintenance departments and all of those things that have produced this tremendous safety record.

Now there is a lot of fat in there. There are a lot of extra things done that the FAA does not require. I know that when an industry is losing a billion dollars, you have a number of managers in there who are all of a sudden trying to think of how they can turn that billion-dollar loss into a profit. They are starting to look at all of those things that I just named for places where they can cut.

I am not coming here with the final result today and saying it has already come out the bottom, and this is where safety is going. I am coming here with the instincts of a pilot, that tell you that all of these things we know produce this great safety record of ours are under the scrutiny of a manager who has to turn a profit; and if this industry cannot turn a profit, then we know—we are certain—that the safety record of this industry will slide; to what end, to what purpose?

Senator KASSEBAUM. You mentioned support for a zone of reasonableness concept. How would that benefit the Air Line Pilots Association?

Mr. DUFFY. We think that will remove the financial pressure from the airlines.

Senator KASSEBAUM. Well, most airlines that I certainly—one here supported today. Two did not. Most airlines have been strongly supportive of deregulation.

Mr. DUFFY. I've never heard so many people happy over losing money. We don't think that the managers in this business have gotten control of the pricing structure. There are a lot of theories out there as to why they have not, but the fact is that they have not, and they have not dealt with a deregulated market.

It is reflected in the bottom line. I hear them blame it on a lot of things. I hear them blaming it on the controllers or on fuel or on whatever, but we do not see it that way.

Senator KASSEBAUM. I think you would have to agree the recession has had an impact.

Mr. DUFFY. Certainly, but the airline industry prior to deregulation had not lost money as a group since 1947, and there have been a lot of recessions.

Senator KASSEBAUM. Because they were protected.

Mr. DUFFY. That's right. We're saying that there should be some measure of pricing protection reimposed because it does not benefit the public interest to see this industry lose a billion dollars a year.

Senator KASSEBAUM. You think it is wise to protect an unhealthy, a weak company as well?

Mr. DUFFY. No, you see——

Senator KASSEBAUM. That is what happens.

Mr. DUFFY. I've heard the theory about how we should allow bad managements to fail. We think that an inefficient carrier is still going to lose money under the zone of reasonableness, but the efficient carrier has two choices. He can either price at the standard industry price level and make a lot of money, or he can price at the bottom of the zone and be the low-cost operator in that market.

But that certainly rewards him for his efficiency. So we don't think there is any contradiction there.

Senator KASSEBAUM. Mr. Ekedahl, one of the things that has seemingly occurred in the price, the fare war is that some of the low density areas have suffered enormous fare increases. I would think this would affect regional services. Are you not seeing it?

Mr. EKEDAHL. Well, the effect that the fare wars have on the small communities is, and our people have been affected by it, is that the people there have a hard time comparing the cost of the short haul flight to the discount long haul flight. Our people, our airlines have had public relations problems in their communities trying to explain how this can be.

The other problem is that there is a tendency to drive to the hub and get your discount flight. So these have had their impact.

Senator KASSEBAUM. Yet you say you have had 80 percent growth?

Mr. EKEDAHL. Yes; we have had during this 4-year period an 80 percent growth in passenger enplanements. I think our people are wary of the discount phenomenon, but on the other hand I think they view any alternative as undesirable and are reluctant to suggest that this is irrational pricing. It has had an effect on the short haul small community operator, as I described to you, but we haven't had price wars to any great extent among our carriers in the short haul market.

Senator KASSEBAUM. Do you feel you would—how would you succeed, if you have given any thought to it, under a zone of reasonableness plan? Do you feel that some of the new carriers would suffer?

Mr. EKEDAHL. I think the intent there is to tend to rationalize it as a long haul and short haul within a carrier and, of course, our people are primarily short haul so in the zone of reasonableness there is certainly no cross-subsidy among our carriers.

So I suppose if it was a rule that might not affect us, really.

Senator KASSEBAUM. It might not affect you in any way?

Mr. EKEDAHL. Yes, that doesn't have any appeal to us. I don't think that would affect our operations very much because they are all short haul.

Senator KASSEBAUM. Thank you very much. We appreciate your participation in the panel.

Mr. EKEDAHL. Thank you.

Mr. DUFFY. Thank you, Senator.

Senator KASSEBAUM. The next panel is Mr. John Auer, director, Department of Nebraska Aeronautics; and Mr. Marshall Arnold, chairman of the Steering Committee of Communities for an Effective Air Transportation System.

Welcome, Mr. Auer. Would you like to start off?

STATEMENTS OF JOHN R. AUER, DIRECTOR, DEPARTMENT OF NEBRASKA AERONAUTICS; AND MARSHALL P. ARNOLD, CHAIRMAN, STEERING COMMITTEE, COMMUNITIES FOR AN EFFECTIVE AIR TRANSPORTATION SYSTEM, ACCOMPANIED BY RUSSELL KLAY, DIRECTOR OF ADMINISTRATION, OMAHA AIRPORT AUTHORITY

Mr. AUER. Thank you, Madam Chairman.

Senator KASSEBAUM. Or perhaps, let me say, Senator Exon will be back in just a minute. He had to go to the Armed Services Committee to vote.

Perhaps, Mr. Arnold, you might lead off, and then Mr. Auer will be ready when Senator Exon gets back. I am sure he would like to be here.

Mr. ARNOLD. Thank you, Madam Chairman. I would like to introduce also Mr. Russell Klay, who is director of administration for the Omaha Airport Authority.

As you know, CEATS testified before this subcommittee during the summer of 1981. As we said then, and continue to believe today, it would be wrong to conclude that simply because many cities are worse off today than prior to the passage of the Airline Deregulation Act, that deregulation has been a failure.

In many markets, much of the public has gained better airline service over the past 55 months. On the other hand, there are many communities that are understandably unhappy with some of the changes in air service that have taken place, and millions of air travelers see themselves as worse off. We do not believe that this a necessary result of deregulation.

Neither do we believe that reregulation is the answer, since in all likelihood it would interfere with many of the benefits produced by deregulation. However, as the experience of the past 2 years has demonstrated, the nature of these problems is not such that time and a healthy economy will cure them.

Indeed, many of the same service problems that existed when we last testified persist today, including the pattern of airlines taking refuge at the major hubs, consolidating services through major hubs, and adding additional services through these hubs in lieu of more direct services. Something can be done, we believe, which will

address the problems associated with deregulation without doing violence to the concept and the benefits it has produced.

In essence, it requires the offering of a temporary but exclusive license to airlines as a means of enabling them to offer services in city pairs which have otherwise failed to attract service. The program would work like this:

In any city pair market identified on the basis of particular airports, not cities, without nonstop service, an exclusive route franchise would be available to one carrier, the franchise being available for 3 years as long as the carrier operates a minimal level of roundtrip service on a nonstop basis. It would be available to the first carrier filing to serve the market, and the carrier would have 90 days to institute service using aircraft with more than 60 seats.

If the carrier failed to provide service at a minimum level of service for at least 4 weeks during any 5-week period, another carrier could file to serve that market precluding the first carrier from reentering.

Finally, we would suggest that the program expire on October 24, 1988, consistent with the expiration of the essential air service program.

It is very important to understand that this proposal does not, for several reasons, constitute reregulation. First, the only actions to be taken by a governmental agency are to establish a system for the filing of notices by interested carriers to initiate service and to operate a time clock by which to establish priorities if more than one carrier is to file in a given market.

Moreover, once a carrier has initiated service in a market, there is no requirement that the carrier must continue to provide service.

Finally, given the size of the market involved, it is highly unlikely that the franchise granted to a carrier will, as a practical matter, preclude additional service in the market. Indeed, if the market were large enough to support two carrier nonstop service, there would almost surely be a carrier providing nonstop service today.

From a more positive perspective, this noninstrusive market-oriented program holds potential for the creation of an extremely dynamic but stable operating environment. Exclusive entry into an unserved nonstop city pair would provide substantial incentive for carriers to enter markets not currently being served.

By combining existing services with a new, exclusive nonstop segment, the award of a single city pair franchise would immediately result in improved service to a wide range of destinations and could, over time, result in improved levels of service in nonfranchised city pairs as well.

By designating city pairs on the basis of airport rather than the city served, improved service opportunities for presently underutilized airports will be created. Perhaps most importantly, this program would result in an environment where fares would naturally tend to be more equitable and competitive in all types of markets.

The excessive downward pressure on fares in the long-haul high density markets would be alleviated because of the incentive for carriers to initiate nonstop service in markets where route integrity would be assured.

Moreover, the continuing availability of service via the hubs would be present as a check to prevent unreasonably high pricing in the franchised city pair. In practice, the carrier operating the franchise route can charge no more than the fare for the connecting service plus the real value for the nonstop service.

If the franchise carrier determines that it is in its best interests to charge less, more not less fair competition will result.

Finally, implementation of the program would also serve to alleviate three other problem areas: first, airline earnings deficiencies; second, airport congestion and access; and finally, the future economic vitality of midsized and small cities around the country.

The essence of our proposal was captured quite well last year by Alfred Kahn during his William A. Patterson transportation lecture given at Northwestern University. In discussing the CEATS proposal he said:

> Yet I cannot deny that some insulation from competition would diminish the risk and so might possibly attract a new entrant that might otherwise be deterred by the possibility of the previously dominant carrier duplicating its improved service perhaps until the entrant was driven out of the market.

He went on to say that:

> In the end, I do not flat reject the CEATS proposal, especially if it is tried on an experimental basis in communities that have demonstrably suffered severe losses of service. If there is an insufficient market there, the offer of exclusivity for three years will not impose any costs on innocent parties so far as I can see.

We appreciate the opportunity to appear before you again, and will be pleased to respond to any questions.

[The statement follows:]

STATEMENT OF COMMUNITIES FOR AN EFFECTIVE AIR TRANSPORTATION SYSTEM

Madam Chairman and Members of the Subcommittee: My name is Marshall P. Arnold, chairman of the Steering Committee of Communities for an Effective Air Transportation System (CEATS) as well as Deputy General Manager of Finance and Economic Programs of the Regional Airport Authority of Louisville and Jefferson County, Kentucky. We appreciate the opportunity to appear before this Subcommittee to discuss the state of the airline industry, focusing particularly on service in medium-size markets.

As you know, Madam Chairwoman, CEATS testified before this Subcommittee during the Summer of 1981 when the so-called "Early CAB Sunset" legislation was being considered.[1] At that time, CEATS documented the adverse effects of deregulation on service to various communities in the United States, and proposed a transition legislation program to deal with these problems in a non-intrusive manner.

As we said then and continue to believe today, however, it would be wrong to conclude that, simply because many cities are worse off today than prior to passage of the Deregulation Act, deregulation has been a failure. Deregulation was advocated not so much for the specific results it would produce but as a program which would be inherently more efficient by permitting transportation services to be allocated, and prices to be determined, by market forces. And, in many markets, much of the public has gained better airline service over the past fifty-five months.

On the other hand, there are many communities that are understandably unhappy with some of the changes in air service that have taken place and millions of air travelers see themselves as worse off—and we do not believe that this is a necessary result of deregulation.

As we explained previously, the problem is that the Deregulation Act failed to recognize that there are at least three tiers of air service in this country. Air service is not just a question of the rich and the poor—there is a substantial middle class consisting of medium-size markets connecting communities that depend on good air service but that cannot, at this time, compete with the airlines' perception of the

[1] A list of the members of CEATS is attached as app. A to this testimony.

security attendant to providing service through the major hubs, and are not afforded the guarantee of air service available to small communities.

Reregulation is not the answer to the problems of these markets since it would, in all likelihood, interfere with many of the benefits produced by deregulation. However, as the experience of the past two years has demonstrated, the nature of these problems is not such that time, and a healthy economy, will cure them. Indeed, many of the same service problems that existed when we last testified persist today, including the pattern of airlines taking "refuge" at the major hubs, consolidating service through the major hubs, and adding additional service through these hubs.

The problems faced in these markets are system problems, and, at least for a transition period, the system is unable to discipline itself. Something can be done, we believe, which will address the problems associated with deregulation without doing violence to the basic concept and the benefits it has produced. In essence, it requires the offering of temporary but exclusive licenses to airlines as a means of enabling them to offer services in city-pairs which have otherwise failed to attract service. The premise is that in a deregulated environment airlines have been reluctant to try to develop service in economically attractive, but presently unserved, city-pairs because the risk of loss is too great in relation to the perceived security afforded by providing service at the larger hubs. Much like the granting of exclusive contracts by corporations to encourage the development of an innovative product or piece of machinery, the assurance of protection from competition for a period of time would, we believe, based on converstaions with individual airlines, be sufficient to shift the balance to one favorable to the offering of the service. Such a program would work in the following manner:

First, in any city-pair market (identified on the basis of the particular airports, not cities, served) without nonstop service (i.e., either no nonstop service or nonstop service that is operated at a level below one roundtrip per day, five days per week), an exclusive route franchise would be available to one carrier.

Second, the franchise would be exclusive for three years as long as the carrier operates one roundtrip per day, five days per week;

Third, the franchise would be available to the carrier first filing a notice to service the market;

Fourth, the carrier would have to initiate the service within 90 days of the filing of the notice, and utilize aircraft having more than 60 seats;

Fifth, if the carrier failed to provide the minimum level of service for at least four weeks during any five-week period, another carrier could file a notice to serve the city-pair on an exclusive basis, thus precluding the first carrier from reentering the market; and

Finally, the program would expire on October 24, 1988, consistent with the expiration of the "essential air service" program (which, in essence, provides subsidies for service to smaller communities).

As with any such proposal, a variety of questions have arisen as to what this proposal is and, perhaps more importantly, what it is not. Beginning with the latter concerns, it is critically important to understand that this proposal does not, for several reasons, constitute deregulation. First, the only actions to be taken by a governmental agency under this proposal are to establish a system for the filing of notices by interested carriers to initiate service, and to operate a time clock by which to establish priorities if more than one carrier chooses to file a notice in a given market. Moreover, once a carrier has initiated service in a market, there is no requirement that the carrier must continue to provide service—only the opportunity for another carrier to enter the market upon the suspension of service by the first carrier. And finally, given the size of the markets involved, it is highly unlikely that the franchise granted to a carrier will, as a practical matter, preclude additional service in the market. Indeed, if the market were large enough to support two carrier nonstop service, there would almost surely be a carrier providing nonstop service in the market at the present time.

In the last analysis, the proposal does no more than put to use a governmental resource which is now itself lying dormant—the right to issue an exclusive license—as a means of maximizing the amount of air service that will be offered in a deregulated environmnt. Beginning with the patent system, the U.S. has used licenses, not to constrain business (as was once the case for airlines), but to encourage its development in areas that were otherwise barren.

From a more positive perspective, this non-intrusive market-oriented program holds the potential for the creation of an extremely dynamic, yet stable, operating environment.

First, automatic entry into an unserved nonstop city-pair would provide a substantial incentive for carriers to enter markets which are not currently being served.

Second, by combining existing services with such a new, exclusive nonstop segment, the award of a single, city-pair franchise would immediately result in improved service opportunities to a wide range of destinations, and could, over time, result in improved levels of service in the non-franchise city-pairs as well.

Third, by designating city-pairs on the basis of the airport, rather than the city, served, improved service opportunities for presently under-utilized airports will be created and the exclusive nature of the franchises will substantially increase the likelihood that the service will be initiated and sustained.

Fourth, this concept would encorage the creation of new carriers and their entry into these franchise markets in addition to the dense markets in which such carriers have chosen generally to initiate service.

Fifth, and perhaps most importantly, this program would result in an environment where air fares would naturally tend to become more equitable and competitive in all types of markets. The excessive downward pressure on fares in the long-haul, high-density markets would be alleviated because of the incentives for carriers to initiate nonstop service in markets where route integrity would be assured. The redevelopment of services in these markets would stimulate traffic as well as recapture traffic that was rerouting through the high-density, long-haul routes when unrealistically low fares were available in the market. Moreover, the continuing availability of services via the hubs would be present as a check to prevent unreasonably high pricing in the franchise city-pair. In an extreme case, the franchise carrier might price the service so high that traffic is driven to the alternative connecting service, thereby reducing the carrier's traffic to the point that it must either reduce price in order to recapture traffic or face certain demise in the market. Thus, in practice, the carrier operating the franchise route can charge no more than the fare for the connecting service plus the real "value" of the nonstop service. To charge more will drive passengers to the connecting services. And if the franchise carrier determines that it is in its best interest to charge less, more not less fare competition will result as passengers route over the nonstop service.

Finally, implementation of this program would also serve to alleviate three other problem areas: airline earnings deficiencies; airport congestion/access; and the future economic vitality of midsize and small cities in the country. Airlines would once again find themselves in a stable economic environment in which prudent management decisions could be made with the expectation that reasonable economic results for the airline would be realized. The problems of airport access and congestion would be alleviated greatly because of the incentives to develop services that would often bypass major hub operations. And, the economic prospects of mid-size and small cities would return to a more stable status as new air transportation services develop at these communities, thereby enhancing their ability to attract new industrial and commercial activity.

We we stated in our earlier testimony, the CEATS proposal will not accomplish miracles. It is, instead, a marketing tool to be used by communities for inducing airlines to provide new service in markets that can truly support air service without imposing burdens on other markets. The essence of the proposal was captured quite well last year by Alfred Kahn during his William A. Patterson Transportation Lecture given at Northwestern University, when, in discussing the CEATS proposal, he said:

"Yet I cannot deny that some insulation from competition would diminish the risk, and so might possibly attract a new entrant that might otherwise be deterred by the possibility of the previously dominant carrier duplicating its improved service—perhaps until the entrant was driven out of the market. I cannot, therefore, reject the proposal on principle. Indeed, it reminds me of my own serious consideration of a similar proposal in the Midway case, in which most of the localities and state authorities, urging certification of the new Midway Airlines, asked us to let it have exclusive rights for a year or two in order to give it an opportunity to become established.

* * * * * * *

"In the end, I do not flatly reject the CEATS proposal, especially if it is tried on an experimental basis, in communities that have demonstrably suffered severe losses of service. If there is an insufficient market there, the offer of exclusivity for three years will not impose any costs on innocent parties, so far as I can see."

Madam Chairwoman, we appreciate the opportunity to appear before the Subcommittee, and would be pleased to respond to any questions that you or the members of the Subcommittee might have.

[Appendix A]

CEATS MEMBERS

The following 25 communities and the Commonwealth of Puerto Rico, representing every region of the United States as well as airports of varying size, support the CEATS proposal:

Huntsville, Alabama
Montgomery, Alabama
Oakland, California
Sacramento, California
San Jose, California
Daytona Beach, Florida
Jacksonsville, Florida
Tampa, Florida
Indianapolis, Indiana
Des Moines, Iowa
Topeka, Kansas
Wichita, Kansas
Louisville, Kentucky
New Orleans, Louisiana
Flint, Michigan
Grand Rapids, Michigan
Minneapolis/St. Paul, Minnesota
Kansas City, Missouri
Omaha, Nebraska
Rochester, New York
Columbus, Ohio
Commonwealth of Puerto Rico
Chattanooga, Tennessee
Knoxville, Tennessee
Austin, Texas
Norfolk, Virginia

QUESTIONS OF SENATOR RIEGLE AND THE ANSWERS THERETO

Question. Medium size hubs without Essential Air Service protection that are located near major hubs are losing significant passenger boardings to the major hubs where drastically reduced fare ticket wars are available. This condition induces passengers to drive, increases congestion at major hubs and jeopardizes service at medium hubs. What can be done to resolve this disparity?

Answer. We believe that the enactment of the CEATS proposal will result in carriers providing nonstop service in city-pair markets which can be served on a profitable basis. Typically, these city-pair markets are those which are currently served through intermediate major hubs. With the development of such nonstop service in such markets there will be a shift in traffic flows that more accurately reflect market demand. It is a well established fact that improved service in a given market stimulates traffic for a variety of sources. Those who were travelling to a major hub by whatever means to get transportation to their ultimate destination will in most instances begin utilizing the nonstop service. The mere existence of more convenient service will result in increased travel in the particular city-pair market and the availability of those direct services will to a degree alleviate the congestion in major hubs caused by those passengers who are needlessly going through the hubs as they begin to use the more direct service. This in turn frees capacity of the major hubs for the further accomodation of those passengers which are truly best serviced by the hub and spoke service, i.e., those passengers travelling in city-pair markets which do not economically justify nonstop service.

Question. Past practice permitted major carriers who were providing their own feeder service from smaller communities to maintain reasonable fares through subsidies and absorbing some loss, if necessary on feeder routes to assure long route and total system profitability. After deregulation, the major airlines abandoned the feeder routes, subsidies have been reduced and mandatory joint fares eliminated. How can reasonable service and access to service to preserved for this public utility which is essential to the economic survival of lower density areas?

Answer. As indicated in our testimony, the CEATS proposal is essentially designed to encourage additional service in markets sufficiently dense to support nonstop service with large aircraft. We do envision, however, that the CEATS proposal could provide certain benefits to smaller communities. For example, there may well be smaller cities that presently cannot justify service to other cities except a large hub, but may be sufficiently large to support additional service to a city being served pursuant to the CEATS proposal. In addition, the airports developed under the CEATS proposal may, in some instances, be more accessible to smaller communities than large hubs. In short, while our proposal will not solve all of the problems

of service to small communities, we believe that it may well expand the service opportunties available to these cities.

Senator KASSEBAUM. Thank you, Mr. Arnold.

Mr. Auer?

Mr. AUER. Thank you, Madam Chairman.

I am John Auer, the director of aeronautics for the State of Nebraska. I am representing Governor Bob Kerrey. I am also chairman of the National Association of State Aviation Officials' Air Service Policy Council. But because of the pressures of time, it was not possible to coordinate testimony which would fairly represent my fellow NASAO directors' position, and I therefore do not speak for them.

I can assure you, however, that, from personal contact, my testimony represents the position of many of the Midwestern States on section 419 of the act. We have been talking about deregulation, but largely we have been talking about a totally deregulated segment of the industry. I am going to talk about a segment that is now still quite heavily regulated.

My department has been in the forefront of the battle to preserve air service to small communities since long before deregulation. Senator Exon, when he was Governor, was instrumental in pointing out the need for change in the way we were providing service to small communities. We worked with Senator Zorinsky when he was on this subcommittee during the writing of the Airline Deregulation Act to insure that Nebraska's concerns were considered.

We have little quarrel with the final version, but the Civil Aeronautics Board in their administration of the act has completely missed the point in one very important aspect. From the very beginning, the Board has selected the lowest bidder in competitions to provide essential air service. This of course has provided air service of a very poor quality.

In Nebraska it meant the provision of service in old, badly rundown Beech-99's by a carrier with bad financial problems. As a result, enplanements dropped drastically in every community where replacement service was provided. You are hearing many theories as to why enplanements have dropped off so precipitously—poor service, small airplanes, the state of the economy, high fares, lack of promotion. We believe all of these factors contribute to the drop in enplanements, and we have tried to identify the causes specifically in Nebraska.

We ourselves spent $25,000 advertising commuters and we talked a commuter carrier into trying a 50-percent fare reduction for 60 days.

We believe that most of these problems stem from the basic philosophy of the Civil Aeronautics Board that the section 419 program was not intended as a development program. That philosophy accounts for the lowest bid policy which, in turn, has led to unreliable service and high fares. With no mandate to develop markets, the CAB provides little or no promotional funds in their subsidy calculations and requires that high fares be used in revenue projections.

When section 419 was being written, I believe that the intent of Congress was not to provide the cheapest service which would be

located, but that is what happened. The Airline Deregulation Act's section 419 program has been successful in only one regard. It has greatly reduced subsidy costs under what would have been required under the section 406 program. In the process, it has almost destroyed the small community air service program.

As I see it, the Congress has three options it should consider for the 419 program. No. 1, it can do nothing. This will certainly insure the demise of scheduled air service to most small communities in 1988.

No. 2, with a very few changes in the Airline Deregulation Act, the Congress could make clear to the Department of Transportation that when it takes over the section 419 program next year, it expects the DOT to provide the funding and the assistance necessary to development of small community markets.

The increased subsidy costs required to accomplish this would be negligible in comparison to what we are spending to support urban transportation systems. Because of the 5 years we have lost in failing to provide adequate subsidy, it may be necessary to extend the subsidy program beyond the projected 1988 date.

No. 3, in accomplishing the previous option, a reexamination of essential air service criteria may be necessary. A study should be initiated to reidentify those communities to whom scheduled air service is, in fact, essential and which have some hope of success.

I have been highly critical of the section 419 program in these remarks, but I would remind my fellow section 419 critics, as I remind myself from time to time, that the alternative to deregulation, continuation of the section 406 program would, by this time, have resulted in subsidy costs many times the present costs.

As I also remind myself, complaints about our section 406 subsidy service before deregulation were many and those complaints were justified. We are all familiar with the good things that have come about through deregulation. The failure of the section 419 program is no reason to return to regulation, but we should in the years remaining to make it, too, work.

Thank you, ma'am.

[The statement follows:]

STATEMENT OF JOHN R. AUER, DIRECTOR OF AERONAUTICS, STATE OF NEBRASKA

I am John Auer, the Director of Aeronautics for the State of Nebraska. I am representing Governor Bob Kerrey. I am also Chairman of the National Association of State Aviation Officials' Air Service Policy Council. Because of the pressures of time it was not possible to coordinate testimony which would fairly represent my fellow NASAO Directors position and I therefore do not speak for them. I can assure you however that my testimony, which I will confine to Section 419 of the Deregulation Act, represents the position of many of the midwestern states.

My Department has been in the forefront of the battle to preserve air service to small communities since long before deregulation. Senator Exon, when he as Governor, helped us, in presentations to the Old West Regional Commission, to point out the need for change in the way we were providing service to small communities. We worked with Senator Zorinsky when he was on this subcommittee during the writing of the Deregulation Act to insure that Nebraska's concerns were considered. To a large degree those concerns were provided for in the Act and we have little quarrel with the final version except that, apparently, the intent of Congress was not spelled out explicity enough. The Civil Aeronautics Board, in their administration of the Act, has completely missed the point in one very important aspect. Until very recently I had not understood the motivation of the Board in the way they were administering subsidy. From the very beginning the Board has selected the lowest

bidder in competitions to provide Essential Air Service. This, of course, has provided air service of a quality and type which insures drastic erosion of the markets being served. In Nebraska it meant the provision of service in old, badly rundown Beech 99's by a carrier with bad financial problems who was more concerned with staying alive financially than in providing good reliable air service. As a result, in the linear route serving Chadron, Alliance and Sidney, Nebraska, enplanements dropped from nearly 9,000 in 1968, in the best year of Frontier's service to 8,000 in 1979 the last year of Frontier's service to less than 2,500 projected for 1983 based on enplanements during the first five months of 1983. For a real horror story let's look at Columbus, Nebraska which used to average about 250 monthly enplanements with Frontier's service and which has been averaging less than 20 per month lately with replacement commuter service. In fairness it should be said that a new carrier, using slightly larger airplanes and with a lower fare structure, began service the first of this month and the market is showing some signs of life.

You are hearing many theories as to why enplanements have dropped off so precipitously. Some say its poor service in smaller airplanes, some say it's the state of the economy. Many say it is high fares. Lack of promotion by the replacement carrier is responsible say others. We believe these factors all contribute to the drop in enplanements and we have tried experiments to try to identify the cause in Nebraska. As one replacement carrier took over we spent $25,000 in advertising money to educate people that commuter service, despite smaller airplanes, would be an improvement. The new carrier then, because of equipment age, maintenance problems and weather entered into a period of very poor service, dropping at one time as low as a 60 percent completion rate. We talked a carrier into trying a 50 percent fare reduction for 60 days and enplanements dropped even further. As for the economy, Nebraska has not been impacted as badly as many other sections of the country but our small community enplanements are down, much further on a percentage basis than enplanements are nationwide.

We believe that many of our problems stem from the basic philosophy of the Civil Aeronautics Board that the Section 419 program was not intended as a development program. The Board revealed this philosophy in their answer to the May 18, 1983 General Accounting Office Report concerning Essential Air Service criteria. That philosophy accounts for the "lowest bid" policy which in turn has led to unreliable service and high fares. With no mandate to develop markets, the CAB provides little or no promotional funds in their subsidy calculations and requires that high fares be used in revenue projections. The replacement carrier enters the market with two strikes on it and unless it is willing and able to underwrite development costs itself, little hope of expanding the market.

When Section 419 was being written, I believe the intent of Congress was to duplicate the highly successful Air Midwest story in Kansas wherein Air Midwest, with the help of flow-though subsidy, was able to provide more frequent service in good equipment and the markets responded dramatically, doubling and tripling enplanements in several communities.

This obviously has not happened. The Deregulation Act's Section 419 program has been successful in only one regard: It has greatly reduced subsidy costs under what would have been required under the Section 406 program. In the process it has almost destroyed the small community air service program. The enplanement figures I previously quoted are being duplicated all over the country.

As I see it, the Congress has three options it should consider for the 419 program.

(1) It can reinforce the CAB's belief that there was no intent to develop small community markets in the original Act by doing nothing. This will certainly insure the demise of scheduled air service to most small communities in 1988. In accepting this option the Congress should consider the energy implications down the road when gasoline again becomes scarce and expensive. Driving one hundred miles to a hub may not then be a reasonable alternative to air service.

(2) With a very few changes in the Deregulation Act the Congress could make clear to the Department of Transportation that, when it takes over the 419 program next year, it expects the D.O.T. to provide the funding and the assistance necessary to the development of small community markets. The increased subsidy costs required to accomplish this would be negligible in comparison to what we are spending to support urban transportation systems. Because of the five years we have lost in failing to provide adequate subsidy, it may be necessary to extend the subsidy program beyond the projected 1988 date.

(3) In accomplishing the previous option a re-examination of essential air service criteria will be necessary. A study should be initiated to reidentify those communities to whom scheduled air service is, in fact, essential. The criteria to be used, in addition to historic enplanement data, should include proximity to other scheduled

air service, recent enplanements and the quality of service which resulted in those enplanements, recent socio-economic developments which may have changed the need for, and the essentiality of air service. Some communities which are not now EAS communities may be included when this factor is added as a consideration. Undoubtedly under this re-examination some communities now receiving subsidized service will not qualify. Whether such communities should be carried through to 1988 or terminated earlier should be spelled out. We would recommend that the 1988 date be maintained. The identification as a community destined for cut-off in 1988 may well stimulate some communities to activity which might forestall such a cut-off. If it is decided to terminate subsidized air service to some communities prior to 1988, consideration should be given to providing subsidized ground transportation directly to the terminal of the nearest connecting point.

I have been highly critical of the 419 program in these remarks but I would remind my fellow critics as I remind myself from time to time; that the alternative to deregulation—continuation of the 406 program would, by this time, have resulted in subsidy costs many times the present costs. And, as I remind myself, complaints about our subsidized service before deregulation were many. And those complaints were justified. We are all familiar with the good things that have come about through deregulation. The failure of the 419 program is no reason to return to regulation but we should try in the years remaining to make it too, work. I have confined my remarks to the 419 program but I am prepared to respond to questions concerning any other section of the Act.

Thank you.

QUESTIONS OF SENATOR EXON AND THE ANSWERS THERETO

Question. Mr. Auer, you cite a number of instances in the State of Nebraska where under the Essential Air Service program, the potential for long-term, profitable service has deteriorated substantially. As the State Director of Aeronautics, are you satisfied with the EAS program and the manner in which it is being administered by the Civil Aeronautics Board?

Answer. Recent decisions of the Civil Aeronautics Board in cases concerning Nebraska communities have largely corrected previous problems caused by the "low bid" philosophy. For instance, Swearingen Metroliners have replaced the tired old Beech 99's in six communities and Twin Otters have replaced the Beech 99 in one other. Whether it is too late to correct the damage already done to these markets remains to be seen.

Question. As the Chairman of the National Association of Aviation Official's Air Service Policy Committee, you must have some insight on the feelings of other states receiving EAS service. How do your state counterparts feel about the adequacy of the program?

Answer. I know of no state which is satisfied with the EAS program. Most of them feel that the quality of their air service has grossly deteriorated under the Section 419 program.

Question. Would simply increasing the amount of subsidy available to each Essential Air Service point help resolve the problems you now are encountering?

Answer. No. But it would help a lot. As I said the quality of Nebraska's air service has improved immensely recently. There are still some problems with reliability which could be improved with the availability of one more Metroliner as back-up for Pioneer's whole system. Additional subsidy which was specifically provided for advertising and promotion would be helpful. Unfortunately some communities are just too close to other airports where good service is available. I am afraid no amount of subsidy would solve that problem.

Question. At this point in time, given your recommendations for revising the EAS program, should the Congress consider extending it beyond the October 1988 termination date?

Answer. Yes. That option should certainly be considered but only after a study is conducted to try to identify those communities which have some chance of responding to such an extension. I see no point in extending subsidy to those communities where there is no such hope.

Senator KASSEBAUM. Thank you very much, Mr. Auer.

I certainly agree and we heard in yesterday's testimony, too, that we need to reevaluate the criteria used in the selection of the EAS points. But I would ask you if it is not always true that CAB selects the lowest bidder. You were pretty definite in that statement. It is

not a criteria that CAB uses. They do, I think, make a great effort, in defense of CAB, to consider community needs and so forth.

Mr. AUER. One of the things that occurs is that, even if a carrier presents a bid which would permit certain innovative promotional fares and some advertising money, in what they call the rate conference, the staff members of the CAB gradually hack away at that until that money is no longer in the proposal.

We have seen it happen and I talked to airline presidents that it has happened to. They have cut it down to the bare minimum and then it backfires, because instead of being able to develop the market and get more people on board, the yields go down, the fares go up to take care of that, and pretty soon you have got nobody riding the airlines.

We have one community that is being subsidized that last month was down to 20 passengers, a community that used to develop 400 passengers a month.

Senator KASSEBAUM. Why is this? Are they going to a hub? Are they driving?

Mr. AUER. They are close enough to a hub that that is a viable option for them, to drive.

Senator KASSEBAUM. Well, then they are probably——

Mr. AUER. That is where they are coming to.

Senator KASSEBAUM. Do you think that is wrong?

Mr. AUER. What I would like to do is give them one more chance or one chance at good service with good fares and see if they go back to their previous habits. The roads are no better than they were when they were putting 400 people——

Senator KASSEBAUM. It is probably cheaper to drive.

Mr. AUER. It was a lot cheaper to drive then than it is now.

Senator KASSEBAUM. What is the distance in this particular instance?

Mr. AUER. It is 55 miles and the parking certainly at the hub is a lot more expensive than it was in those days. I am talking about Omaha.

Senator KASSEBAUM. In Mr. Arnold's mentioning his proposal and suggestion for granting exclusive rights for 3 years to a carrier, would that apply to a situation such as this, Mr. Arnold?

Mr. ARNOLD. No. We are talking about——

Senator KASSEBAUM. Where you could feed into—for instance, what service would you be, Omaha to Kansas City? What type of market.

Mr. ARNOLD. What type of market?

Senator KASSEBAUM. Yes.

Mr. ARNOLD. We would envision this affecting markets, substantial sized markets. We are talking about markets that carriers can economically operate and generate good profits. I can give you examples out of Louisville.

Senator KASSEBAUM. So it is not essentially to help essential air service type communities?

Mr. ARNOLD. No, it is not.

Senator KASSEBAUM. You would already be going into areas where there is already competition there, but you are proposing this just to stimulate nonstop services? Is that essentially it?

Mr. ARNOLD. Yes. There are many markets of sufficient size to justify nonstop service. Generally speaking, these markets are served through major intermediate hubs today where, prior to deregulation, we had much more of a linear route system than we do today. We find more and more concentration through the hubs.

We do not have a problem with the hubs. We recognize the very valuable service they perform. But everyone should not be forced through a hub when there is a market there that will warrant better service.

Carriers are precluded from providing that service, because of the existence of that intermediate hub. The typical city pair that we are talking about is served many times by the same carrier all the way through by way of a hub with connecting services. He simply is not going to sit idly by while someone else overflies his hub and takes away what, in some cases, is a long haul traffic and a sizable number of passengers.

Senator KASSEBAUM. If you agree on such an exclusive operation, what would you do to the hub spoke mechanism that has evolved since deregulation?

Mr. ARNOLD. You will not do any injury to the hub, because we are talking about a pretty nominal number of city pair markets. For example, out of Louisville we can identify four to six markets that might be served in that manner. It is not going to substantially detract from the hub.

Now, we are not suggesting either that you are going to have, let us say we would have two nonstop roundtrips in five markets. Louisville may not have a net gain of 10 flights a day. There will be other shifting of services.

We do not envision that we will gain on a 1-to-1 basis, but in those markets where there is a demand for those services that a carrier can provide on a profitable basis, it seems to make more sense for those people to be accommodated on the more direct service.

We have had experience with carriers who wanted to go into such a market just right at the time that deregulation occurred and the Board's adoption of the multiple, permissive entry. At that time, carriers who have announced to plans to start up in those markets had abandoned plans when the multiple entry policy of the Board was adopted.

Senator KASSEBAUM. If they have a service to offer that they feel will be supported, would that not be the best way to do it? Why give them that market advantage over the competition if indeed it is something that really has that much community support?

Mr. ARNOLD. If you have a market, whatever the number of passengers may be, to support a two roundtrip operation on a profitable basis, you probably have a carrier today that is serving it through an intermediate hub. But the revenues that he generates flying from point A to point C through point B is very substantial. He is not going to sit by while someone else puts in a service from A to C. He is probably going to protect that because he has a very good revenue stream coming from that service through the hub.

What in all liklihood is going to happen if someone puts in the A to C nonstop service, a carrier going A, B, C will start flying A to C, too. You will have an overabundance of service in the market

for a short time until the newcomer decides he cannot take it anymore. He is going to get out.

The carrier who has traditionally dominated service A to C through the hub is going to revert back to his hub service. You simply are not going to get the service unless there is some way for a carrier to become established in the market.

Senator KASSEBAUM. Well, in a way it is going back to regulating part of it based on an assumption that that is what would be best for that market area.

Mr. ARNOLD. Well, there is no doubt that there are some rules involved, so it is a form of regulation. We truly do not believe that we are jumping back in and regulating the industry in any substantial manner. It is a mechanism that if we are dead wrong, no one will take advantage of it and there is not anybody out anything for the effort. We do not believe we are wrong.

Senator KASSEBAUM. Mr. Auer, in many ways Nebraska and Kansas have some similar problems. One of the things that has developed in recent years for service, say, in western Kansas in trying to either get to Denver or Kansas City or Witchita is that the fares have become so high that it is really prohibitive for many to fly. Now, how best do you think that can be addressed?

Mr. AUER. It is beginning to improve. Some of the larger airlines are now beginning to realize that this feed that they get from these small towns, although they may be minor from one small town, when you put two and three and four of these towns together in one commuter airline, that feed becomes important to them and they are now beginning to romance the small commuters with decent joint fares.

The town that I just talked about that had 20 passengers last month has now got a new commuter in there with apparently better connections because they have been able now to promote a $20 add-on fare to many of United's key cities. Now, previously it was costing $60 to get to Omaha. Now that, I think, should develop that market again if it is not too late, and if they can provide reliable service to do that.

Now of course, that still does not solve the problem of people who are going to one of the other cities that are not attractive. But I see Pioneer Airlines in our Western communities developing some good fares also with Frontier. Now, so long as those can connect to Frontier cities, you have got decent fares.

Senator KASSEBAUM. Is this something your department works with?

Mr. AUER. It is something we have been preaching to them for 5 years with, up until now, very little success.

Senator KASSEBAUM. Well, perhaps it is beginning——

Mr. AUER. I suppose the realities of the marketplace have brought it home that they cannot continue to charge those high fares and, of course, many of our Western communities have even closer competition than Denver. They can run over to Scotts Bluff, a matter, instead of 150 miles, a matter of 50 or 60 or sometimes 80 miles and get on Frontier and Frontier has decent fares there, because they want to feed their own market.

Many of these airlines apparently did not realize what was happening to them. They were charging, even Frontier, for instance,

was charging a high fare from Scotts Bluff to Denver and then you had good promotional fares from Denver. What they did not realize and they do now, apparently, is that people were driving to Denver. Then they were getting on any airline, when they did have the opportunity in Scotts Bluff to lock in that passenger on his longer trip.

They are beginning to realize that in the small communities now. Whether it is in time to salvage anything, remains to be seen.

Senator KASSEBAUM. Well, it seems to me it will if it is to the benefit of the passenger and the consumer there and that ultimately is what does tell how the system is going to work.

I will suggest that we will keep the record open if Senator EXON has any questions. Why do not we submit these for the record, because I know they are voting in the Armed Services Committee today.

Mr. AUER. Yes, I understand.

Senator KASSEBAUM. Thank you very much. We appreciate your comments.

The next witness is Mr. Dick Knodt, president of the American Society of Travel Agents. Mr. Knodt.

STATEMENT OF RICHARD C. KNODT, PRESIDENT, AMERICAN SOCIETY OF TRAVEL AGENTS, INC., ACCOMPANIED BY PAUL M. RUDEN, SPECIAL COUNSEL,

Mr. KNODT. Thank you, Madam Chairman. The American Society of Travel Agents, Inc., ASTA, is the world's largest trade association of professional travel agents with more than 10,000 domestic agent members. We appreciate the opportunity to address you about the issues of deregulation.

I have with me Paul Ruden, special counsel to ASTA, who will assist in responding to any questions you may have. Our prepared testimony describes the travel agency industry in some detail, so I will proceed directly to the deregulation issues affecting travel agents.

Professional travel agents are very small businesses who are authorized to represent virtually all airlines through an industry accreditation program. For many decades, these programs have allowed multitudes of agents to enter the market each year, more than 4,000 between 1974 and 1978.

Every one of them, regardless of size or assets, started business with equal access to all airline inventory. Today, there are more than 22,000 fully accredited agency locations throughout the United States.

Clearly, travel agents were quite familiar with free entry and exit long before deregulation became the law for the airlines. We are not strangers to competition. Although it received little attention during the debates leading to deregulation, the nationwide professional travel agency system has played a central role in allowing the airline industry to adapt to a less regulated environment created by the airline deregulation act.

The agency system enables existing airlines to enter new markets easily by providing a ready-made network of agents to represent the carrier. That network also helps airlines get started. They

have immediate access to a nationwide distribution system on equal terms with established carriers.

Equally important, the professional agency system expertly and efficiently informs the consumers of the vast array of air fares available to them and alerts them to the services of new airlines with unfamiliar names. The conference programs, which produce an industry agent system, thus enhance airline competition and minimize public confusion and inconvenience from the free entry, exit and pricing that are the goals of airline deregulation.

Deregulation of the airlines has led to the proliferation of diverse, constantly changing prices and services presenting great opportunities and also imposing great burdens on a bewildered consumer. The professional industry accredited travel agent is the only impartial and objective source to which the consumer can turn for expert assistance in finding the best travel value in this confusing and chaotic air travel market.

In this kind of market, which can be expected to continue indefinitely, the travel agent's task is to collect, assimilate and explain vast amounts of information from 150 airlines and countless other travel suppliers located all over the globe. The industry travel agent is a source of information for customers without parallel in any other industry.

As the historical record implies, the effect of deregulation on travel agents has not been primarily to alter the basic character of the industry. It has, instead, fulfilled the destiny of the industry agent as a promoter of competition between different airlines and as a promoter of retail competition in the sale of individual airline services.

Without the industry agent network, deregulation simply would not have occurred as it has thus far. The corollary point is that if the agency network is imperiled, the future of competition in the deregulated marketplace and its acceptance by the public is likewise threatened.

We now turn to some specifics which have received much attention in connection with deregulation. It is a fact that domestic airfare commissions on the average are higher today than they were in 1978.

There are three simple reasons why. One, because of chaotic market conditions a much larger percentage of the traveling public is seeking the professional assistance of travel agents, thus increasing the agents' market share.

Two, there are 6,000 more travel agency locations today than there were in 1978. And three, commission rates prior to 1980 had been kept artificially low by commission setting agreements among the airlines.

If one looked no further, it might appear that the increase in travel agent compensation has been a windfall for travel agents, but it makes no sense to look at the income side of a financial statement without also looking at the expense side.

Only about 2,000 of 14,000 agency locations in existence in 1979 had installed automated reservation systems. Since then, more than 15,000 additional locations have invested in automation at tremendous expense. And the numbers continue to increase daily.

This investment was essential to cope with the staggering changes in fares and services that airline deregulation has produced. While automation was intended to increase productivity, it has recently served only to offset declines in productivity caused by the need to spend more time advising clients, and by the need to reissue tickets repeatedly to accommodate rapid price changes.

An industry investment of this magnitude, involving a 750-percent increase in the number of automated locations in just 3 years would not have been possible if the commission rates had remained fixed at pre-1980 levels. Thus, while individual agents may have experienced improvement in market share and commission rates, they have had to make substantial investments in automation to keep pace with changing market conditions.

An objective appraisal of deregulation to date must recognize that travel agency services at current commission levels represent a genuine bargain for the airlines and the traveling public. The agency network has allowed the airlines to shift to travel agents the time-consuming burdens of dealing directly with the public in complex transactions and thus avoid huge investments themselves.

The ebb and flow of demand and the task of servicing clients affected by changing prices and services is absorbed, to a large extent, by the agent. Under existing commission practices, the agent receives only one commission no matter how much time is spent reissuing or revalidating documents.

When prices spiral downward from discount fares, the commission drops proportionately. No other industry can obtain this quality and quantity of service at a 10 percent markup.

The biggest problems are yet to come. Any assessment of deregulation must recognize the implications of the CAB's own program to profoundly alter the marketing of air transportation.

I refer to the Board's decision in late 1982 in the *Competitive Marketing* case. The Board, in that case, stripped away the underpinnings of the accredited industry agent network and set in motion forces which, if allowed to proceed, will destroy the industry's cooperative accreditation program.

If that program fails, the situation faced by airlines, agents and consumers will change dramatically. Detailed analyses of the implications of the CMI decision have already been submitted to the House Subcommittee on Antitrust and Restraint of Trade Activities and will later be presented to this subcommittee and to the House Aviation Subcommittee in separate hearings devoted to the subject.

These analyses show that industry costs will rise and that the present network of agents jointly representing all airlines will shatter through attempts of individual airlines to secure a dominant, or perhaps exclusive, distribution system. The end result will be an airline system that is less competitive and less efficient than the present one, a system that will not serve the public as we have previously described.

A balanced look at deregulation, then, must acknowledge that the past deregulation record was produced under conditions not likely to prevail in the future if the CMI decision stands. The nationwide network of jointly accredited travel agents representing

all airlines has uniquely contributed to the intense competition and management freedom that has taken place since 1978.

That is why the travel agency community has supported and promoted S.764 which is before this subcommittee to restore the essential predicates upon which deregulation was based.

Thank you, Madame Chairman.

We will be happy to answer any questions you may have.

Senator KASSEBAUM. Thank you. I was interested to hear you say that you thought chaotic market conditions would continue indefinitely. I do not know if you have been here for most of the morning but, on the whole, I would say that several of the witnesses felt very strongly that they would improve, that there were already in place certain factors that were going to help stabilize the fare wars and some of the erratic behavior that has been present recently. You do not see this occurring?

Mr. KNODT. Not at all, ma'am. For every executive you can find that says this should all come out in the wash sooner or later, you will find five more that will say I do not think this will ever end, when you have 150 competing carriers.

Senator KASSEBAUM. And yet a majority support deregulation. Do you see, in your study of the field, some concept necessary, such as the zone of reasonableness, some guideline under which all airlines can set, within certain percentages, their fare?

Mr. KNODT. That subject, I have not studied that intensely myself. Mr. Ruden may have something to add to it.

Mr. RUDEN. Madam Chairman, I do not think at this point in the process ASTA would take a position on the question of possible intervention.

Senator KASSEBAUM. You have other worries?

Mr. RUDEN. Well, yes we do.

I think the essential point we are trying to make is that one cannot assume that all the conditions that existed in the early years of deregulation, which have tended to make it work, albeit with mixed results, you cannot assume those conditions will continue to prevail.

The witnesses who testified about the future of the fare structure in the Marketing case made some observations about whether the market, and pricing practices, would tend to moderate. As some of these witnesses have suggested, and the theory on which they all proceeded was, indeed, all discounts should be eliminated eventually.

The reason was that under the economic theory that drives that kind of testimony, all prices will fall toward costs and since the cost essentially is the same to carry each passenger between A and B, they all ought to end up paying the same price.

I think market reality teaches us and changes in economic conditions from time to time, that occur from time to time, teach us that that theory simply does not play out in the real world. And that is one of the bases for ASTA's view that you are likely to continue to see, if not on a continuous basis, certainly periodic waves of price discounting and what some people would say is price irrationality.

Mr. KNODT. I think the key point to the travel agents and travel agents industry is this, no matter what happens, by having a fully accredited industry travel agent representing 150 carriers, new car-

riers, old carriers, carriers changing markets—no matter what happens in that arena, that industry agent is the buffer between the chaotic market conditions and sorting it all out for the consumer. I do not know what the effect would be without that industry agent.

Senator KASSEBAUM. I think everyone would agree with you there that the agent has been and will continue to be a buffer. I know you are worried about what might happen due to other decisions, but I really do not see that role changing.

I think that it has been so important, through a time of great uncertainty, that the traveling public has come to rely on the travel agent to a great extent and I just cannot see that changing, no matter what other factors may come into place.

Mr. RUDEN. Madame Chairman, the problem is not so much that the demand for this kind of service will change, but that the capacity of the industry to produce it on a cooperative basis will change primarily because of the loss of the antitrust immunity for the program that makes it possible.

Senator KASSEBAUM. As you say, some of these competitive marketing decisions and so forth will come under the scope of a different hearing, and we will be doing that in September. But we appreciate your contribution to this hearing and realize that it is a very important consideration to you as far as what happens with deregulation and the success of those efforts.

Mr. KNODT. Thank you very much.

[The statement follows:]

STATEMENT OF THE AMERICAN SOCIETY OF TRAVEL AGENTS, INC.

Madame Chairman, the American Society of Travel Agents, Inc. (ASTA) is the world's largest trade association of professional travel agents, with more than 10,000 domestic agent members and a total worldwide membership of agents and suppliers exceeding 18,000. Before addressing the issues of deregulation that are before your committee today, we would like to review briefly the nature of the travel agent industry and its crucial rule in providing impartial and professional advice to the traveling public.

I. THE TRAVEL AGENCY INDUSTRY

Like most travel agents, the overwhelming majority of our agent members are small businesses. Average full time employment in our industry is about six persons per agency. Gross sales of all services per agency average less than $2 million. Commissions earned on the air travel portion of these sales average ten percent. The Small Business Administration classifies travel agencies as "small business" if they have gross commission revenue under $2 million. On that basis almost all agents are small businesses. The charts following depict the basic characteristics of our industry.

Although agents share the trait of small size, we are proud to note the diversity of opportunity that has existed in our industry under the professional accreditation standards that we discuss in this testimony. A very thorough survey conducted in October, 1982, showed that 46 percent of travel agencies are owned by women and that 11 percent are owned by minorities.

Because of the accreditation system that results in automatic appointment of each qualified agent by all conference airlines, each new agency, regardless of size and assets, starts business with equal access to all airline "inventory". The integrated nationwide network of travel agents that is produced by the accreditation agreements has evolved, with the oversight and approval of the Civil Aeronautics Board, over a period of forty years. This system has served the airlines and the public exceptionally well. It lowers costs and helps sustain demand. It is extremely competitive and at the same time remarkably stable.

The number of travel agent locations has grown steadily and rapidly to the point where there are now more than 22,000 agency locations throughout the United States. The agency industry has experienced substantial entry by new competitors

and great diversity in the marketing approaches taken by individual agents. Agency failures occur at an extremely low rate. Even when an agent does fail, the tickets it has issued are honored by the conference airlines.

Conversely, because the airlines can rely on a common system of agents, they have been able to guarantee substitute transportation for the public on agent-issued tickets when an airline ceases operations. The system thus provides the public with greater security in making air travel arrangements, and provides the airlines with a stable distribution network that now accounts for more than half of all airline sales. The extraordinary stability and rapid growth of our industry is depicted on the following pages.

The agency system created by the accreditation agreements has promoted competition in many important ways and in particular has played a central role in enabling the airlines industry to adapt to the less regulated environment envisioned by the Airline Deregulation Act of 1978. The agency system enables existing airlines to enter new markets easily by providing a ready-made network of agents to represent the carrier in the new territory. That network also helps new airlines get started—they have immediate access to a national distribution system on equal terms with established carriers, thus avoiding an enormous financial burden in start-up costs. Equally important, the professional agency system expertly and efficiently informs consumers of the array of rapidly changing air fares available to them and alerts consumers to the services of new airlines with unfamiliar names. The conference travel agency system thus enhances airline competition and minimizes public inconvenience from the free entry, exit, and pricing that were the goals of airline deregulation.

II. THE EFFECT OF AIRLINE DEREGULATION ON TRAVEL AGENTS

The present market of air transportation is beset with an information problem of staggering proportions. Deregulation of the airlines has led to the proliferation of diverse, constantly changing prices and services from which the consumer must select the combination that represents the best value for him. The professional industry-accredited travel agent is the only impartial and objective source to which the consumer can turn for expert assistance in finding that best value. In an increasingly confusing, and often chaotic, air travel market, the "industry" travel agent, representing 150 airlines throughout the world, is a source of complete and objective information for consumers without parallel in other industries. In this kind of market, which can be expected to continue indefinitely, the travel agent's task is to collect, synthesize and explain vast amounts of information from travel suppliers located all over the globe.

As the historical record implies, the effect of deregulation on travel agents has not been primarily to alter the basic character of the industry—it has instead fulfilled the destiny of the industry agent as a promoter of competition between different airlines and as a promoter of retail competition in the sale of each individual airline's services. Without the industry agent network, it is fair to say that deregulation could not have occurred as it has thus far. The corollary point is that if the agency network is imperilled, the future of competition in the deregulated marketplace, and its acceptance by the public, is likewise threatened.

We now turn to some specifics which have received much attention in connection with deregulation. It is a fact that domestic airfare commission rates on the average are higher today than they were in 1978. This resulted from the CAB's decision in 1980 to allow commission rates to be determined competitively. For the prior forty years rates had been kept by airline agreement and, as one would expect, those agreements set the rates below the competitive level. When that agreement was eliminated, the rates increased, as was expected. Domestic rates followed the course of international commissions, which were opened several years earlier, by increasing and then levelling off. The current average rate on all agent sales is just under ten percent. The present air commission rate is equal to or below rates offered by non-air suppliers who are, incidentally, not subject to any form of exclusivity in their choice of agents to represent them. Airline commission rates thus compare favorably with compensation provided by similar service suppliers.

It is also a fact that the airlines' total commission payments to agents have increased since 1978. This is accounted for in part by the rate increases just discussed. But there is another major factor at work, and that is that the travel agents' share of total air transportation sales has also increased, from about forty-six percent of domestic sales in 1978 ($11.4 billion) to somewhat more than 60 percent in 1982 ($21.8 billion). This increase in sales is itself the result, in large part, of the confusion that deregulation has produced for the public. Services are changed frequently,

as carriers enter and exit new cities. Yet general public awareness of the details of these changes is very limited. And fares change virtually every day, with airlines offering new fare classifications, eligibility rules, discounts and gimmicks by the hundreds.

Deregulation has thus made more important than ever, the travelling public's need for a place to obtain complete, current and objective information about their price and service options. That place has been, and remains, the accredited industry travel agent.

If one looked no further, it might appear from the numbers presented above that deregulation has been a windfall for travel agents. But let us look beneath the surface of the statistics. The fact is that the travel agents of 1978 did not simply fall heir to a near doubling of business, at higher compensation, in four years time. More than 6,000 new agency locations opened during that same period. In fact during 1982 an average of five new locations opened every day. Thus, travel agents have themselves experienced a substantial increase in competition for the public's patronage since the advent of deregulation. And the entry continues—as of last month, the number of travel agents doing business in the United States exceeded 22,000.

It is also the case that in early 1979 only about 2,000 of the 14,000 agency locations then in existence had installed automated reservations systems. Since then more than 15,000 additional locations have invested in automation at tremendous cost, and the numbers continue to increase. This investment was essential to cope with the staggering changes in fares and services that airline deregulation has produced. While automation is intended to increase productivity, it has, in recent years at least, served as much as an offset to declining productivity caused by the need to spend more time advising clients and by the need to reissue tickets repeatedly to accommodate rapid price changes. An industry investment of this magnitude, involving a 750 percent increase in the number of automated locations in just three years, would not have been possible if commission rates had remained fixed at the pre-1980 levels.

Thus, while individual agents may have experienced improvement in market share and commission rates, they have had to make substantial investments in automation to keep pace with changing market conditions. Deregulation then has been no panacea for travel agents. We note with concern that the number of agency defaults more than doubled between 1981 and 1982.

An objective appraisal of deregulation to date must recognize that travel agency services, at current commission levels, represent a genuine bargain for the airlines and the traveling public. The agency network has allowed the airlines to shift to travel agents the time-consuming burdens of dealing directly with the public in complex transactions and thus avoid huge investments in overhead. The ebb and flow of demand and the task of servicing clients affected by changing prices and services is absorbed to a large extent by the agent. Under deregulation, it is sometimes necessary to reissue a ticket two or three times. Under existing commission practices the agent receives only one commission, no matter how much time is spent reissuing or revalidating documents. When prices spiral downward from discount fares, the commission drops proportionally. No other industry can obtain this quantity and quality of service at a ten percent markup.

The biggest problems are yet to come. We understand that this is not the principal topic before the committee at this time, but any assessment of deregulation must recognize the implications of the CAB's own program to profoundly alter the marketing of air transportation. I refer to the Board's decision in late 1982 in the investigation into the Competitive Marketing of Air Transportation. The Board in that case stripped away the underprinting of the accredited industry agent network and set in motion forces which, if allowed to proceed, will destroy the industry's cooperative accreditation program. And if that program fails, the situation faced by airlines, agents and consumers will change drastically. Detailed analysis of the implication of the *CMI* decision have already been submitted to the House Subcommittee on Antitrust and Restraint of Trade Activities Affecting Small Business and will later be presented to this subcommittee and to the House Aviation Subcommittee in separate hearings devoted to the subject. These analyses show that industry costs will rise and that the present network of agents jointly representing all airlines will become balkanized through attempts of individual airlines to secure a dominant, or perhaps exclusive, distribution position. The end result will be an airline system that is less competitive and less efficient than the present one, a system that will not serve the public interest.

A balanced look at the future of deregulation then must acknowledge that the past record was produced under conditions not likely to prevail in the future if the

CMI decision stands. The nationwide network of jointly accredited travel agents representing all airlines has uniquely contributed to the intense competition and management freedom that has taken place since 1978. That is why the travel agency community has supported and promoted S. 764, which is before this subcommittee, to restore the essential predicates on which deregulation was based.

We will be happy to answer any questions that you may have.

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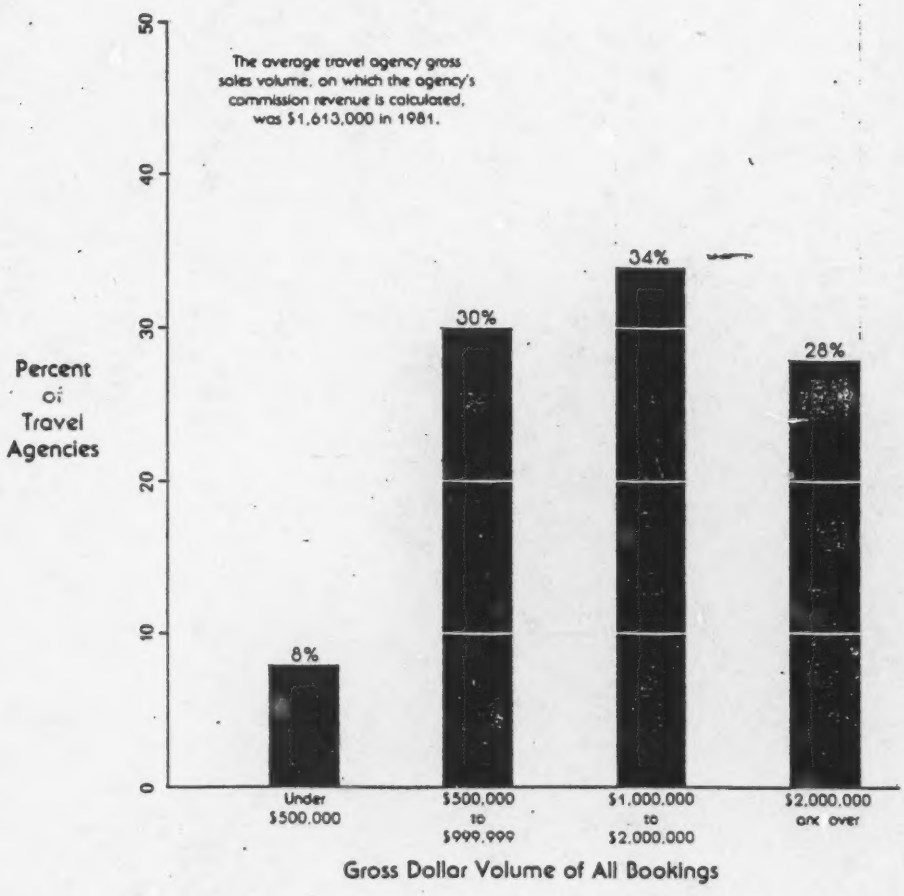
Travel Agency Sales Volume



Source: The U.S. Travel Agency Market 1981, Louis Harris & Associates

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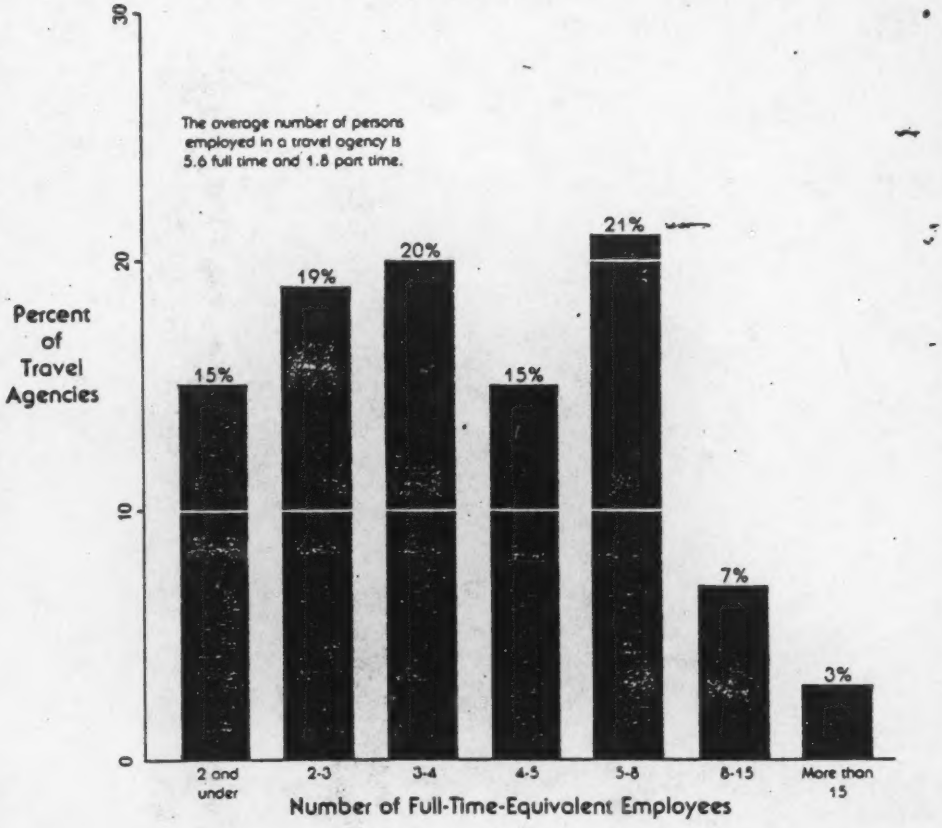
Number of Travel Agency Employees



Sources: The U.S. Travel Agency Market 1981, Louis Harris & Associates
Joint Travel Agent/Airline Economic and Value Study, Touche Ross & Co., 1978

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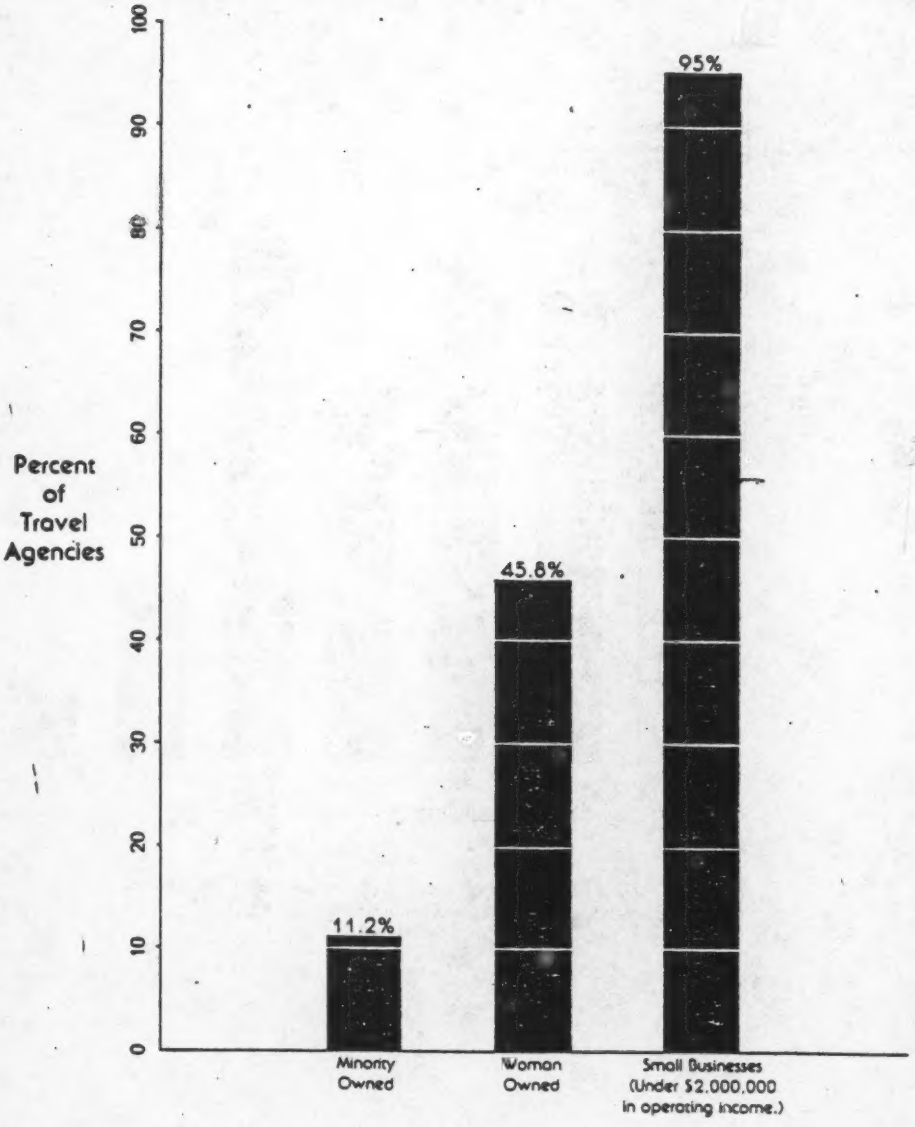
Travel Agency Ownership



Source: ATC Survey, October 1982

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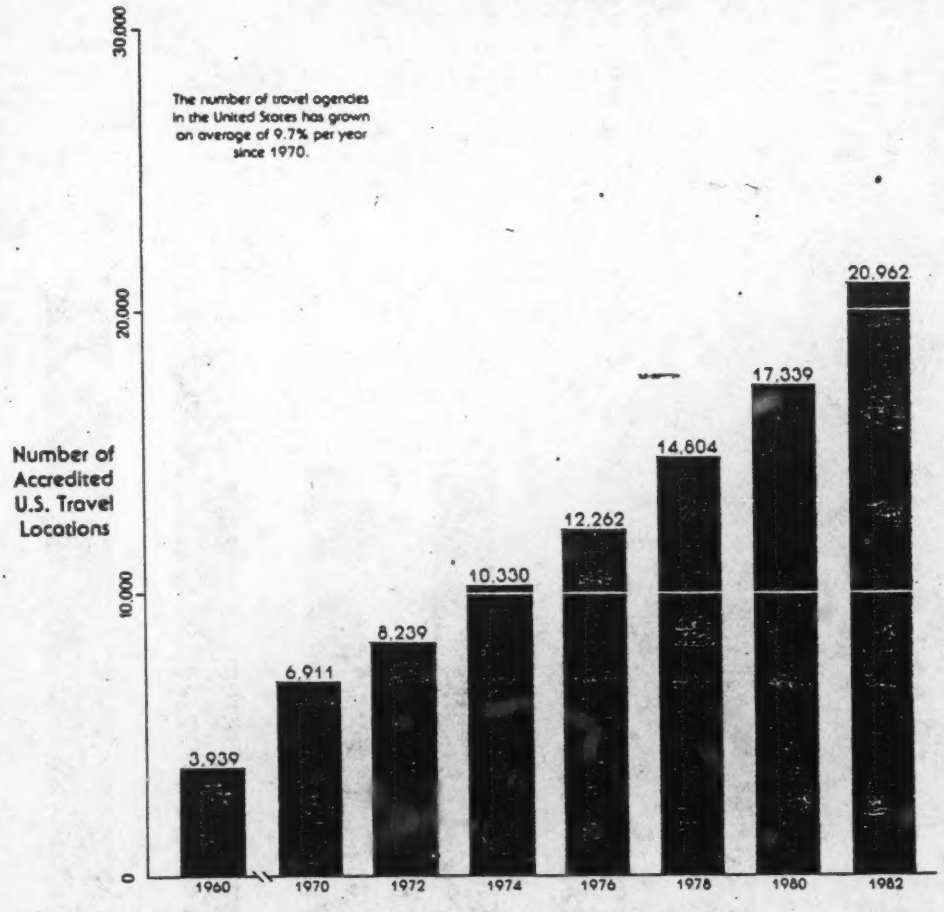
Growth in U.S. Travel Agencies



Source: Air Traffic Conference Data

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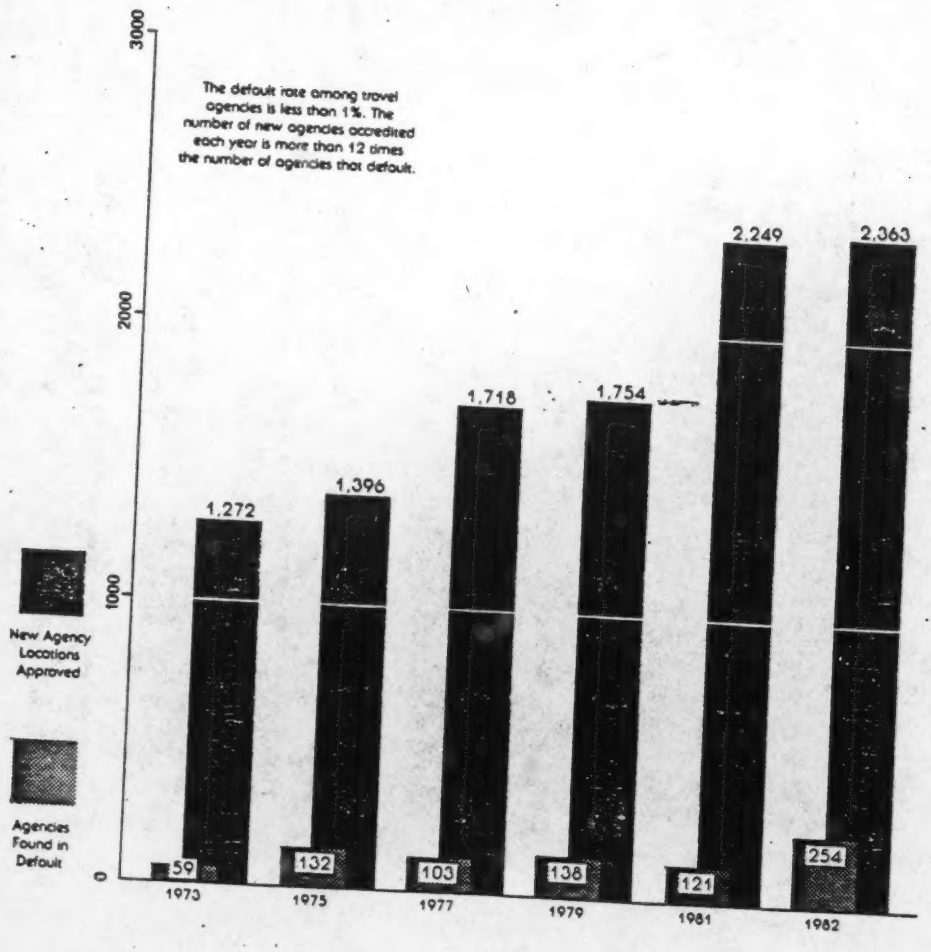
New Travel Agencies vs. Travel Agency Defaults



Source: Air Traffic Conference Data

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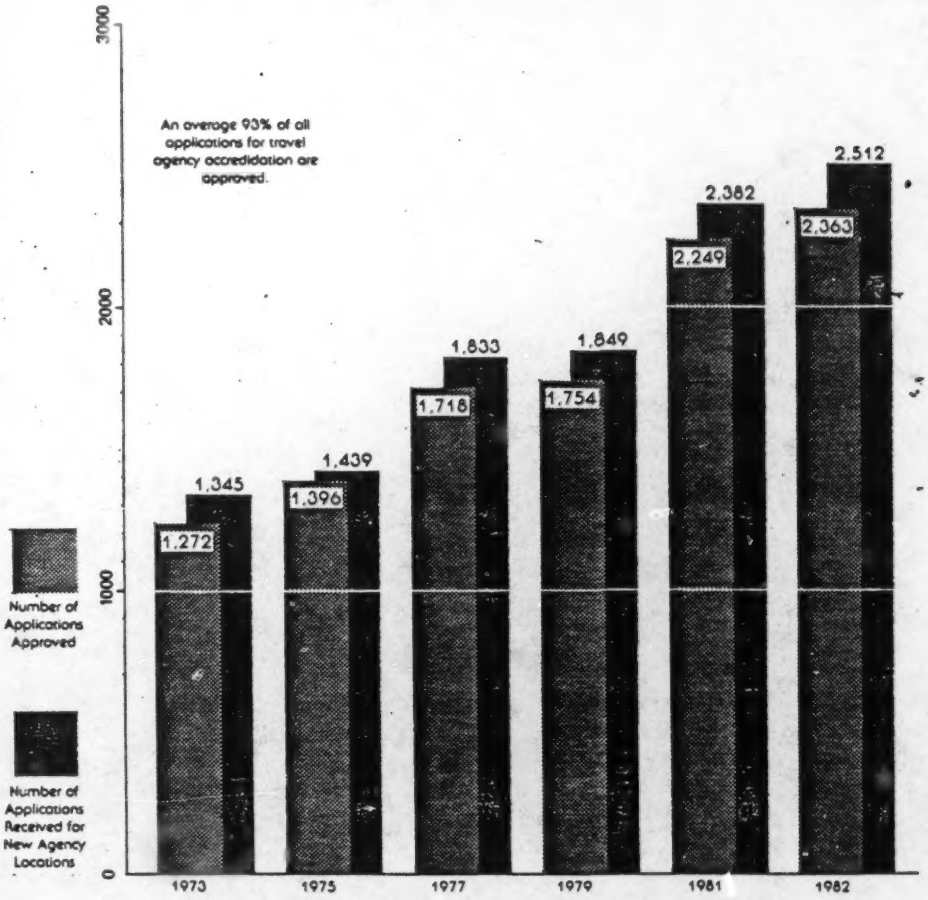
Applications For New Travel Agency Locations



Source: Air Traffic Conference Data

Senator KASSEBAUM. Thank you.
Thank you. That concludes today's hearing.
[Whereupon, at 12:33 p.m., the subcommittee adjourned.]

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ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

Statement of Hon. Alfonse D'Amato, U.S. Senator From New York

Madam Chairman: I thank you for this opportunity to include my testimony in the record for these important hearings. Since enactment of the Airline Deregulation Act, almost five years ago, some profound changes have taken place in the provision of air service in this country. I believe that the State of New York is a microcosm of the air transportation system in our nation and provides a clear picture of some of the ways in which the changes brought by deregulation have affected the travelling public. In particular, our experience in New York demonstrates the varying impact that deregulation has had upon communities of various sizes.

In our state, we have cities and towns and their corresponding airports varying in size from the very large to the very small. The airports range from Kennedy international, the fourth largest in the nation, served by major certificated airlines offering frequent jet service, to small airports served only on an intermittent basis by small commuter airlines (also referred to as regional airlines.)

New York City is served by LaGuardia and Kennedy airports, as well as Newark International Airport in neighboring Newark, New Jersey, which by all accounts is underused. LaGuardia and Kennedy are high density airports with controlled access to landings and takeoffs. As of June 1 of this year, weekly domestic departures from Kennedy numbered 2408 while those at LaGuardia numbered 4437. Since deregulation, new carriers offering high frequency, low cost service have proliferated in these dense markets providing very stiff competition to existing carriers. The people of New York have been well served by new carrier entrants including, among others, New York Air, Peoples Express, and Midway Airlines. At the same time, our citizens have also benefitted from the lower fares and new routes offered by the existing carriers in response to this competitive stimulus. Despite the 1981 air traffic controllers strike and a difficult economy, emplanements at Kennedy and LaGuardia increased by over 16 percent during the period 1977–1981.

In our other large cities, such as Albany, Buffalo, Rochester, and Syracuse, where populations range from 600,000 to 1.2 million, our experience, since deregulation, is probably representative of similarly-sized cities throughout the country. At the airports serving these cities (medium sized hubs according to the Federal Aviation Administration's classification) long haul service has improved since deregulation especially with the addition of service to Florida and the Southwest. At the same time, there have been some decreases in short haul service. Between 1978 and 1982 Syracuse, Rochester, and Albany gained 20, 13, and 15 percent respectively in the number of available seats, while Buffalo experienced a slight decrease of about 4 percent. At these airports, the increase in long-haul traffic (trips over 400 miles) has equalled the national average of 7 percent annually. Short-haul markets (those within 400 miles, which have accounted for almost half of the passenger destinations from these cities) have experienced a rate of traffic growth below the national average.

Nonetheless, there is evidence that the long range effect of airline deregulation will be to increase air service to these cities in both long and short-haul markets. There is more competition in a number of markets from both major and national airlines, and new speciality airlines which are already serving some of these cities' markets have announced their intention to enter more of them. Although some trunk carriers have withdrawn service, such as TWA at Buffalo and Braniff at Albany, replacement service by new carriers or carriers upgrading their type of service have more than replaced the lost service.

Our medium sized cities, Binghamton, Elmira, Ithaca, and Utica, with populations ranging between 100,000 and 300,000 have experienced greater difficulty in adjusting to the forces of deregulation. Each of these cities has an airport, classified by the FAA as non-hub point because of low traffic levels and each is between one and two hours driving time from Syracuse's larger Hancock International. With the exception of Utica, which has become the base for Empire Airlines (a certificated carrier), each of these cities has experienced a decline in the number of available flights,

available seats, and service by large aircraft. Service in each of these cities is in the process of being transferred from a dominant certificated carrier, which has been gradually reducing service, to smaller commuter carriers. Between 1978 and 1981, the number of commuter departures has increased by 47.5 percent at Binghamtom, 8 percent at Elmira, and 47.6 percent at Ithaca. Madam Chairman, while I do not recommend any legislative changes in the Airline Deregulation Act to address the situation existing at medium sized cities, both in New York and throughout the country, I do stress the fact that we must continue oversight efforts to determine whether the transition taking place in our medium-sized cities requires legislative solutions.

Finally, we have a number of very small cities and towns which, with a few exceptions, have small airports with limited service. These include communities which are either eligible for essential air service (EAS) under section 419 of the Airline Deregulation Act or communities which currently enplane more than five passengers per day. Air service is provided exclusively by commuter airlines and, with one exception, each airport is served by only one airline, which transports passengers primarily to one or two hub airports.

It is upon these areas that I will focus the remainder of my testimony. This is not to accentuate the negative impacts of airline deregulation. Indeed it has been a great boon to the residents of the more densely populated areas of New York and, as other witnesses have pointed out, to other areas of the country. Service has improved, and consumer prices for air travel have dropped.

Rather, my purpose is to shift our attention to those problems stemming from the Airline Deregulation Act which require action by the Congress. In focusing my remarks on the experience of smaller communities, I am not unware of other problems that have accompanied airline deregulation which have been addressed by other witnesses before this Committee. I am referring, of course, to the fact that the Department of Labor and the Civil Aeronautics Board (CAB) have been exceedingly slow in making the determinations, promulgating the regulations, and implementing the program required by the labor protection provisons of the Airline Deregulation Act. Almost five years have passed since the law's enactment. Expeditious and careful fulfillment of its mandates is long overdue.

In turning to the effect of deregulation upon our smaller communities and the effectiveness of the essential air service program in dealing with them, I would first like to commend you, Madam Chairman for directing and the General Accounting Office's (GAO) for preparing, its recently issued study of the small communities essential air service program.

In view of our experience in New York, I strongly endorse the GAO's findings that Congress should grant the Civil Aeronautics Board the authority to temporarily increase some subsidies to improve flight scheduling, services, and promotion where this can help a community's air service market become self-sufficient. In a 1981 evaluation of the adequacy of air service, prepared for the New York State Department of Transportation, Simat, Helliesen & Eichner (one of the country's foremost aviation consulting firms) concluded that: "the EAS determinations, are the minimal levels needed to accommodate recent depressed traffic and not the levels that will effectively accommodate historic patronage or promote traffic development and fully capture the latent demand."

In New York, service under this program is currently provided to the towns of Plattsburgh, Saranac Lake, Massena, Ogdensburg, and Watertown, collectively designated as the North Country. Service initially provided under the program in 1978 at Sullivan County Airport in Monticello, New York was discontinued on July 1, 1982, upon the CAB's decision that the area's essential air service determination should be set at zero.

Experience in Sullivan County provides a graphic picture of the need to implement the GAO's recommendation that the CAB be given authority to temporarily increase some subsides in order to encourage development of self-sufficient air service in the smaller communities. Sullivan County lost essential air service despite the fact that its airport is located in an area of Southern New York where tourism, at the well-known resorts of the Catskill Mountains, is the major industry. The history of service in this area lacks any continuity. Certificated service was suspended in 1970 and then reinstituted under subsidy at a minimal level from 1976 to 1978. Upon the certicated carrier's withdrawal shortly, following enactment of the Airline Deregulation Act in October 1978, service was provided under the essential air service program. Neither the first EAS carrier, which terminated service in 1980, nor its successor established a record of dependable service or adopted a marketing program. In light of this, travel agents were reluctant to book tourists on these flights, and this potential source of revenue remained untapped.

This experience, demonstrates the need for subsidy rates sufficient to permit improvements in flight scheduling, services, and promotion. In addition it demonstrates two other areas, not mentioned by the GAO, where authorizing the CAB or its successor to exercise added flexibility in establishing subsidy levels could enhance the EAS carriers' chances for success and eventual self-sufficient service. These include authority to allow higher subsidy rates during the initial service period to help with start-up expenses. Such expenses include the advertising and marketing necessary to build demand and a reputation for high quality, dependable service. In addition, in areas such as Sullivan County where air traffic tends to be seasonal (because of tourism or other factors) a variable subsidy rate providing higher payments during the off-peak season could be helpful in encouraging a more successful operation.

New York's experience with the EAS program in the North Country has also revealed two other areas in which administration of the program by the CAB and its successor agency could be improved. In the North Country, service under the EAS program was initiated in early 1979 by Air North. The subsidy levels set for this service proved to be too low and the carrier unilaterally cut back service below the designated levels, while seeking a higher subsidy. It finally withdrew from the service in the summer of 1981. However, a replacement carrier and a higher subsidy were not approved by the CAB until mid 1982.

This situation points up the need to develop a more efficient procedure for monitoring the performance of EAS carriers, essential air service levels, and subsidy compensation awards. Emplanement figures for the third quarter of 1980 and 1981 show a decline of 35 percent in Plattsburgh, 11 percent in Saranac Lake, 47 percent in Massena, 36 percent in Ogdensburg, and 52 percent in Watertown. In addition, it points to the need to assure a more efficient method of selecting and approving replacement carriers. Long delays in the selection of replacement carriers simply heightens the possibility for service disruptions and decreases demand due to community dissatisfaction with the air service provided.

On the basis of this experience, I must agree with the GAO that, absent such changes and a new emphasis on air service development in communities of this type, it is unlikely that service will continue upon the expiration of the EAS program in 1988. However, I do believe that successful air service operations in our smaller communities is possible under a deregulated environment. This too is based on our experience in New York where there have been some success stories.

In Jamestown, New York, located in the southwest corner of the state, unsubsidized service is provided by the Allegheny Commuter System (affiliated with US Air) and has shown a constant growth for many years, both before and after deregulation. This success is probably due in large part to three factors, Jamestown's population base and market area, which are larger than many other small communities in New York, its geographic location which permits access to a large hub (Pittsburgh) over a distance well suited for commuter aircraft, and, finally, the advantages that accrue to the area's commuter carrier from its association with the Allegheny Commuter operation. This association gives the commuter access to technical assistance and to well-timed connections with US Air at Pittsburgh which serves a large number of destinations with favorable joint and discount fares.

Madam Chairman, I am hopeful, that this experience can be replicated in other areas of the country as the commuter carriers become more established in the deregulated environment. In addition, I urge that we enact the legislative changes recommended by the GAO, by this testimony, and by the testimony of others that will enhance the possibility that air service will continue in our small communities upon the termination of the essential air service program in 1988.

STATEMENT OF WILLIAM J. AUGELLO, EXECUTIVE DIRECTOR/GENERAL COUNSEL, SHIPPERS NATIONAL FREIGHT CLAIM COUNCIL, INC.

AIRLINE DEREGULATION—A CARGO LIABILITY ALBATROSS

Abstract

Is airline deregulation helping the shippers of air cargo?
No.
Is airline deregulation reducing transit losses?
No.
Is airline deregulation improving cargo claims procedures?
No.
Here are the real facts about worsening of air cargo service:

Airline service to meet shipper needs has deteriorated, while rates and charges have skyrocketed.

Air carriers are discontinuing through services and rates where needed.

Despite the explicit instruction by Congress to have air carriers continue tariff filing requirements, the CAB canceled them.

Air carriers are increasing freight rates and charges without prior notice or justification.

Air carriers are discriminating against shippers and receivers of less desirable commodities.

Air service has severely reduced carrier liability for air cargo loss and damage.

Carriers are arbitrarily shortening time limits for the filing of shipper claims.

Air carriers are shifting the burden of proving carrier negligence to claimants.

There is a growing disinterest about the collection and publication of vitally needed loss and damage statistics about air shipments.

Here is what the shipers of America need:

Shippers need stable rates and charges that are not discriminatory.

Shippers need published rate and rules tariffs.

Shippers need uniform carrier liability and claims processing standards.

Shippers need the continued statutory duty that carriers serve all segments of the shipping public without discrimination of undue preference.

Shippers need uniform liability monetary limits and procedural safeguards in the filing and processing of loss and damage claims.

Shippers need a regulatory forum to air complaints about unreasonable rate increases, claims practices and discriminatory actions.

Shippers need reasonable regulatory systems to prevent the destruction of the common carrier system.

Present deregulation trends threaten the impairment of the finest transport service system on earth.

Congress can not allow this to happen.

The attached presentation by Mr. William J. Augello before the Eleventh International Air Forum on September 28, 1982 set forth the conditions prevailing into 1982. Mr. Augello reports that since such presentation, the freight claims and liability problems for air shippers have become worse. He is available at any time for consultations about this worsening situation, which should be of great interest to the members of Congress.

The Deregulation Disaster

(By William J. Augello, Esq.)

A paper delivered at the eleventh international air forum, September 28, 1982; sponsored by the Society of Automotive Engineers.

From a public interest standpoint, airline deregulation has been a colossal failure. Airline management, freed of regulatory restraints, has lowered carrier liability for loss, damage or delay of air freight shipments while sharply increasing rates and charges on air cargo. This action demonstrates that contract terms and conditions do not respond to increased competition in public service industries and that regulatory controls must be retained over such contracts in the public interest.

Airline passenger service has deteriorated at most secondary cities while the fares on these segments have escalated significantly. Most small cities have less available seats than prior to deregulation despite increased competition. Smaller cities are receiving substandard service because airlines are diverting aircraft to more profitable routes.

The economists' "freemarket" theory discarded our former transportation policy which insured all communities reasonable, non-discriminatory service and fares.

This objective was achieved by awarding service rights on the less profitable routes as a quid pro quo for serving the more attractive cities. Congress has breached its commitment to mid-America by repealing a successful statutory policy with a textbook theory. The marketplace theory has proven to be self-destructive to the airline industry. Predatory pricing on heavily travelled routes is forcing rates on other segments to be increased excessively. These results would not have been permitted by an administrative agency enforcing a sound transportation policy which placed the public interest above corporate profits.

These adverse results of deregulation cannot be blamed on the recession, fuel prices, the PATCO strike or high interest rates. The CAB could have reacted to these conditions and preserved the financial stability of the industry as it has in similar past crises.

The airline deregulation experiment has taught the nation at least one lesson: transportation industries are affected with a public interest which must be protected through reasonable federal controls. The marketplace does not protect the public interest adequately where a national transportation network is required.

THE DEREGULATION DISASTER

After five years of experimenting with deregulation of the airline industry and two years of radical change in federal regulation of the railroad and motor carrier industries, it is clear that the removal of certain federal controls over public utility industries has resulted in serious and possibly irreparable injury to the public.

In retrospect, the Administration in 1977 was ill advised to push Congress into enacting airline deregulation legislation in the midst of a recession. The present Administration compounded the prior Administration's errors in accellerating motor carrier deregulation in a deepening recession despite the airline experience.

In brief, deregulation was the wrong political move at the wrong time. Increased competition when less traffic is available spells disaster to a finely tuned network of airlines, railroads, motor carriers, water carriers and pipelines. The fact that transportation is vital to every industry and citizen in this country distinguishes transportation from other unregulated industries, such as food businesses, which might also be deemed vital to the nation. For instance, although everyone needs food, we do not need a network of grocery stores. We need a network of transportation facilities to serve the nation, but a network requires uniform, reasonable regulation by an independent, impartial body of federal regulators possessing expertise in transportation.

Congress recognized the need for financial stability of the national railway system in enacting the Staggers Rail Act of 1980, stating: "The overall purpose of the Act is to provide, through financial assistnce and freedom from unnecessary regulation, the opportunity for railroads to obtain adequate earnings to restore, maintain, and improve their physical facilities while achieving the finacial stability of the national rail system." H. Conf. Rep. No. 96–1430, 96th Cong. 2d Sess. 80, 1980 U.S. Cong. & Ad. News 4110, 4111.

In forming administrative agencies as an arm of Congress, it recognized that transportation was a highly complex subject requiring great expertise and experience. Our administrative agencies had been run by a balanced, informed body of experts since the late 1800's until the economists began to dictate policy in this country.

Unfortunately, the qualifications for the appointment to the transportation regulatory agencies, during the deregulation era, have been the candidate's economic theories, rather than expertise in transportation. As Commissioner Eastman stated, many years ago:

"Zealots, evangelists, and crusaders have a value before an Administrative agency but not on it."

Our modern hard core economic advisors reject the lessons we learned with unregulated railroads in the 1890's, and have convinced the Administration and Congress that there is no difference between grocery stores and transportation companies. They argue that neither should be regulated by a federal agency, and that both should be free to allow the marketplace to dictate entry and pricing, subject only to the anti-trust laws.

The deterioration of our national transportation system during the last five years' experimentation with these economic classroom theories dictates that Congress change its policies before further irreparable harm is suffered by the public and by the carriers involved. This paper identifies the numerous areas in which the public has been harmed by airline deregulation, and the remedial measures necessary to restore reasonable, sound regulation to our once great national transportation system.

Liability terms and conditions

The most convincing evidence of the adverse effects deregulation of the transportation industry has had on the public is the manner in which carrier management has reacted to complete freedom to modify liability terms and conditions in contracts of carriage. Airline management has proven itself particularly adept at this game, followed closely by railroad management.

In almost five years of a deregulated environment, when competition has nearly doubled, air cargo liability rules and regulations have deteriorated significantly. Shippers now have four different time limits to contend with when filing loss and damage claims, depending on the carrier used. Some are as short as 120 days and

100 days compared to the former uniform rule of nine months and nine days. Two carriers even require the filing of a "notice of intent" to file a claim; one within 15 days and the other within 30 days. These are pitfalls for the shipper which enable these carriers to evade liability for a great number of loss and damage claims.

Two carriers have adopted another device to evade liability, reducing the time within which suits must be filed—from two years to one year. Carrier reaction to overcharge claim time limits have followed the same pattern. Shippers now have five different time limits for filing overcharge claims, some as short as 100 days in lieu of the former uniform rule of two years. The suit filing limits on overcharges have been reduced to 180 days, one year, and one year plus six months from disallowance. The prevailing rule before deregulation was two years plus six months from disallowance. (See Appendix A)

With respect to liability limitations, claimants have experienced the same adverse affects. Eleven carriers have reduced their liability limits from $9.07 per pound to 50 cents per pound. Fourteen carriers have reduced their liability even further by applying 50 cents per pound times the weight of the piece lost or damaged, rather than paying for the full value of the piece up to 50 cents times the weight of the entire shipments as was the pre-deregulation practice. (See Appendix B).

These liability limitations were found to be unlawful by the CAB in its seven year investigation concluded just prior to deregulation. (1) [1] The CAB held that the 50 cents per pound limitation which originated in 1861 was anticipated and prescribed the Warsaw limit applying on international traffic ($9.07 per pound) for application on domestic traffic. That limit remained in effect only four months when the Board's power to prescribe reasonable rates, rules and charges was repealed by the Air Transportation Regulatory Reform Act of 1977. (2)

In addition to the above liability limitations, 29 carriers increased their excess value charges to 40 cents per $100 of excess value declared. Prior to deregulation, when several airlines attempted to increase their excess value charges from 10 cents or 15 cents per $100, the CAB rejected their petitions on the ground that they were not justified. Once the Board's jurisdiction over reasonableness was removed by Congress, the airlines increased their charges from 10 cents or 15 cents per $100 excess value to 40 cents per $100 without challenge.

For those carriers that reduced their liability limits from $9.07 per pound to 50 cents per pound, and increased their excess value charge from 10 cents per $100 to 40 cents per $100, the cummulative effect has been a 3900 percent increase. These alterations were unilaterally imposed without supporting evidence of a need for increases of this magnitude and without review by any federal agency. Shippers were powerless to prevent these unjustified, unconscionable increases, as they have lost their only regulatory forum.

All of these adverse changes occurred despite the substantial increase in competition. (3) The underlying theory of deregulation is that competition will flourish when regulatory controls are removed. Competition is deemed desirable since it theoretically will result in lower prices as well as "weeding out" the weak or undesirable carriers while fortifying the strong carriers with good business practices.

Implicit in the economists' deregulation theory is a belief that shippers and carriers are in equal bargaining positions, and that through negotiation, favorable contracts will result. Unfortunately, the results of deregulation conclusively demonstrate that most shippers lack sufficient bargaining power to negotiate equitable contracts. In the absence of a federal mediator, carriers have unilaterally limited their liability and simultaneously increased prices.

These adverse changes in contract terms and conditions took place because not all features of transportation are affected by the marketplace. Liability for loss, damage, and delay has not reacted fairly to increased competition in air freight services, nor in the trucking and railroad industries. The principle reason is that carriers do not sell their services on negative concepts such as their loss record. Transportation services are traditionally sold on the basis of rates and service. Shippers generally do not anticipate the loss or damage of their goods anymore than travelers anticipate the loss or damage of their baggage. This is a lesson which the academic economists must learn and add to their textbooks.

There is another distinction between transportation and grocery stores: A consumer need not enter into a written contract to purchase groceries, but transportation consumers (shippers and travelers) must enter into written contracts (bills of lading or airbills for shippers and tickets for passengers). The terms and conditions of carriage are incorporated by reference into the contract of carriage. The terms are found in tariffs on file in a federal administrative agency in Washington, D.C.

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[1] Numbers in parentheses designate references at end of paper.

and scrutinized by that agency to insure compliance with federal statutory and regulatory laws, as well as the common law.

On November 9, 1978, the CAB exercised its discretionary powers and repealed its regulations requiring the filing of air freight tariffs and liability rules. (4) In doing so, it disregarded the wishes of the Congressional leaders responsible for enacting the deregulation statute, and the desires of airlines, forwarders and shippers as well. (5) The CAB even rescinded its regulations requiring minimum cargo insurance for airfreight forwarders. (6) In lieu thereof, airlines and forwarders must indicate on their rate sheets and airwaybills the limits of their insurance, if any. The shipping public has lost the protection of mandatory cargo insurance similar to that required for motor carriers. (7)

Although the economists have resisted accepting the notion that there could be any exception to their free market theories, the CAB earlier this year indicated a willingness to consider retaining federal controls in connection with baggage liability regulation. One of the options it is considering as part of its examination of consumer protection regulations in anticipation of its sunset is to codify certain of its baggage orders. In support of this option, the Board stated:

"We are concerned, however, that eliminating government oversight of airline baggage practices may have undesirable effects. First, by removing the current minimum liability limits that may be higher than airlines might maintain voluntarily, the Board may reduce the incentives for airlines to use reasonable care in handling checked baggage. Second, airlines might try to shift the risk for damage or loss to their passengers to a degree that is unreasonable in view of customer expectations. Third, we cannot know at this time precisely to what extent legal and economic pressures will by themselves induce carriers to give adequate notice to passengers of liability limitations. In the absence of tariffs, we do not know, for example, to what extent courts will permit contract terms incorporated by reference to bind passengers who are not otherwise apprised of risks. Finally, elimination of baggage liability regulation might permit carriers to circumvent the current regulatory fare ceiling by assessing an additional charge for the carriage of any baggage rather than including it in the fare as is now the case.

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"On the other hand, a competitive marketplace may also create pressures on airlines to minimize costs by reducing the extent of their liability. Despite the importance of repeat business an airline might consider a passenger whose bag has been misplaced to be a lost cause. Consequently, carriers might consider it most cost-effective to reduce their liability limits substantially by contract. Whether the carriers' inclination to reduce baggage liability limits will be effectively restrained by competition is unclear. Competition among airlines did not have that effect prior to 1966, when the Board began to regulate baggage liability. More over, any form of baggage insurance included in the price of a ticket is a negative service element that benefits the passenger only if things go wrong. Airlines, however, have generally been reluctant to highlight potential service failures when promoting their services.

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"Option 3 would go further, limiting the extent to which airlines may shift to passengers risks for fragile or perishable items. By adopting this option, we would prohibit airlines from imposing overly broad disclaimers of liability, as they did until the conclusion of the "Domestic Baggage Liability Rules Investigation" in 1977. This would deal with the concern that some carriers might act unconscionably by trying to contract away most or all of their common law duties and liability for checked bags without providing any cost-savings or other benefits to passengers or without providing notice commensurate with the passenger's risk." (8)

This expression is a clear indication that the CAB has become concerned that the marketplace is not acting as the economists predicted, and that there is an appropriate exception to the deregulatory concept of a free market system when transportation contract terms and conditions are concerned.

In short, an effective and efficient network can not be created without uniform, reasonable rules and regulations, particularly with respect to the terms and conditions of the contract of carriage.

Shippers and travelers alike can best be protected by a uniform contract of carriage prescribed by an impartial government body consisting of transportation-oriented officials and attorneys knowledgeable in the industry and its peculiarities. Without such regulation, travelers will be faced with lower limitations on lost and

damaged baggage, short time limits within which to file claims and other disclaimers of the type found in airfreight tariffs.

Without regulation, shippers will continue to be surprised with unconscionable tariff rules not appearing on the back of airbills, such as the infamous "average value rule". This rule is usually discovered after the loss or damage occurs, when a shipper attempts to recover the full value of a portion of its multi-lot shipment. The rule prevents shippers from recovering the full value of multi-lot shipments, as follows: The declared valaue of a shipment is divided by the entire weight of the shipment to obtain an average value per pound. That value is then multiplied by the weight of the goods lost or damaged. The following example will demonstrate the substantial reduction in liability which results:

A shipment consisting of a computer and nine boxes of paper weighs 1000 pounds with the computer weighing 100 pounds and each box of paper weighing 100 pounds. With a declared value of $40,000 the average value per pound is $40.00 ($40,000 divided by 1000 = $40). If the computer head, valued at $35,000, was the only portion of the shipment lost or damaged, the carrier's liability would be limited to $4,000 ($40 × 100 pounds = $4,000). This result is clearly one that would not have been in the contemplation of the shipper when he entered into the contract with the carrier and paid excess value charges for protection up to $40,000. This rule is just one example of the "sharp" practices or unconscionable limitations which carriers have been permitted to maintain in the free market, and without prior notice to the shipping public.

As the Board noted in its Baggage Liability Rules notice of February 4, 1982, permitting carriers to limit their liability without a prescribed minimum will remove much of the incentive to prevent loss or damage. The Board also observed that carriers may be willing to write-off claimants if the cost trade-offs weigh against carrying higher liability levels for all travelers and shippers. The loss of federal regulation of airline liability rules, therefore, has had and will continue to have undesirable effects on the public interest.

Railroad management has displayed the same disdain for the public when freed from regulatory restraints under the Staggers Rail Act of 1980. (9) When relieved of ICC control over piggyback traffic, most railroads immediately lowered their liability while increasing their rates. In addition, where released rates were published on specific commodities, the railroads stipulated that this traffic would be moved only at the released rates. This policy is in direct conflict with the common law rule requiring carriers to offer a choice of full value rates when they wish to maintain limited value rates.

Appendix C reveals these and other unconscionable limitations on liability incorporated in rail piggyback tariffs when exempt from Interstate Commerce Commission controls. The Commission has, thus far, refused to protect the public from these unlawful limitations of liability, preferring instead to test its "marketplace" concepts and await injury to shippers. (10)

In the interim, the public is suffering irreparable harm through unrecoverable loss and damage to their freight shipments.

The issue at hand, therefore, is whether federal intervention is necessary to protect all travelers and shippers against unconscionable limitations of liability, including those small shippers lacking sufficient sophistication to become aware of the unlawful limitations or lack of sufficient resources to seek appropriate remedies. The public service nature of transportation services dictates that the government retain those regulations traditionally enacted to protect consumers of transportation services before they are injured.

Airline Services

Consumer dissatisfaction with the airline industry operating without government regulation is surfacing with increasing frequency. Passengers have been inconvenienced by unannounced schedule changes and have been "bumped" in unprecedented numbers. (11) "Bumped" passengers are being compensated because the CAB's regulations mandate such compensation. There is little doubt that this form of compensation will disappear if left to management discretion following the Board's sunset.

The cancellation of joint rates, routes, and baggage transfer services is presently being considered by individual airlines. If this is permitted to take place, it will greatly accelerate the collapse of our national airline network. Consumers will bear the cost of dealing with multiple ticketing, baggage transfers, and other inconveniences. Rail shippers are presently experiencing similar added expense as a result of the repeal of the obligation to maintain through rail routes and rates.

The more obvious and common consumer complaints heard since airline deregulation concern the abandonment of service at numerous small cities and communities. Economists attempt to justify these abandonments by arguing they are cost-justified. In some instances, they cite satistics revealing that "departures" have actually increased under deregulation at small communities.

To the unsophisticated traveler, these statistics may be convincing evidence that airline deregulation is working a more significant statistic, however, concerns available seats. Bakersfield, California, for instance, had a 110 percent increase in departures following deregulation. Measured in terms of available seats, on the smaller aircraft used, this resulted in a 17 percent loss of service. Salem, Oregon, suffered a similar loss seats (55 percent) although it experienced a 15 percent increase in departures. (12)

Fifty-two cities experienced fewer available seats as of October 1, 1980, after two years of deregulation. Only one-fourth of the cities have gained seats. Furthermore, there has been a disturbing decline in passengers at communities receiving replacement services under the Air Deregulation Act. (13)

In essence, deregulation has permitted carrier managment to place corporate profits as their top priority consideration, replacing their obligation to provide reasonable service to all points on their certificated routes. The loss of service at cites such as Charleston, WV; Providence, RI; Chattanooga, TN; Norfolk and Newport News, VA has been extensively covered in the press. Between April 1980 and April 1981, 40 cities have lost all of their scheduled service. Economists dismiss these reports by attributing these failures to the recession, fuel prices and the PATCO situation, and contend it is a transition condition which will be resolved in time.

The point is that the irreparable harm suffered by these cities and the citizens and businessmen residing therein would not have happened but for the repeal of the CAB's power to protect the public interest. We have experienced recessions in the past, but our transportation industries were able to weather the storm under the protective arm of the Administrative agencies charged with the obligation of maintaining a strong, viable national transportation system.

Many cities have now been deprived of reasonable service levels, not because service has been unprofitable, but because the equipment was diverted to more profitable routes opened up by deregulation.

These changes in route structures and small city service have been made without regard for the commitment made by the government to these cities decades ago when it enacted legislation mandating economical service to every region in the country. (14) Industry was induced to locate in less densely populated suburban areas and off-route points with the assurance that the regulatory agencies charged with administering transportation policy would compel reasonable service by certificated carriers as a quid pro quo for serving major metropolitan centers. That system worked well for decades and our transportation system grew and prospered under this policy.

Congress has breached that promise by enacting the 1977 and 1978 air deregulation acts, the 1980 surface deregulation acts and more recently the bus deregulation act. (15)

If the marketplace theory is not replaced with a sound regulatory system for all transportation industries, businesses, hotels, resorts, and population in the smaller cities and communities receiving sub-standard transportation service will wither on the vine. Carrier management no longer has an obligation to be concerned for the economic well-being of these secondary cities. Stockton, California, for instance, has already reported major business refusing to relocate in that city because of the lack of adequate air service. (16)

A similar complaint can be heard in many California cities that have lost interstate service to more lucrative intrastate markets since deregulation. According to the California Public Utilities Commission, airline deregulation has had a detrimental effect on California intrastate air transportation. (17) The Commission's study for an 18 month period between September 1, 1978 and March 1, 1980 revealed that the number of seats offered within California decreased by 14 percent. During the 12 months ending March 1, 1980, seats decreased by 19 percent and departures dropped 8 percent. In a more recent study by the same agency, it was reported that in 48 city pairs within California, departures increased 6 percent, but the number of available seats decreased by 21 percent. (18) Furthermore, many communities in California lost the services of carriers using jet aircraft. (19) It is rather ironic that this would happen in California when the lower California intrastate fares were one of the principle justifications advanced by economists in support of deregulating interstate airlines. (20)

"Economic route rationalization" has also occurred in every other state in the union. There is no longer "cross-subsidization" of less profitable routes, a concept which was abhorred by economists, but was embraced by the great majority of cities and communities in the nation. In its place, Congress mandated that the CAB ensure an "essential level of service" for 555 communities for ten years by finding carriers willing to serve those cities, and by subsidizing the last remaining carrier. The taxpayers will not know the total cost of these subsidies for another five years, if ever. Despite the cost, early indications are that this program has resulted in a steady deterioration of service to small communities. (21)

It is questionable if such changes in routes and service will ever be reported by the Federal government in terms of safety, comfort, convenience of departures, available seats, meals and dependable, expeditious service. Thus far, the CAB has emphasized the quantitative statistics and ignored the qualitative evidence. (22)

Airline pricing

The pricing policies made possible by airline deregulation have produced the most illogical, destructive results, from a public interest standpoint. With respect to air cargo rates and charges, deregulation has made it possible for airlines to substantially increase the cost of shipping cargo by air. Between January 1978 and January 1979, such rates rose 89 percent on minimum charge shipments, 21 percent on 100 pound shipments, 76 percent on 5,000 pound shipments, and up to 900 percent on accessorial charges. Surcharges on live animals, human remains, hazardous materials, and articles of extraordinary value have generally doubled. Expresstype service rates have greatly increased. (23) The total increase to date of the cost of shipping by air is well over 50 percent. These unbridled increases are necessary to subsidize the "supersaver" and other discount fares proliferating throughout the industry.

Thus, deregulation has not produced materiel pricing benefits to air shippers. Indeed, the elimination filed tariffs prevents shippers from knowing what their competitors are paying for similar services and prevents their detection of discriminatory rates and services.

With respect to airline passenger fares, the removal of the CAB's power to judge the reasonableness of air fares has permitted airlines to increase fares excessively in all but the heavily travelled markets such as California and Florida. Fares have escalated to a point where they are discouraging travel rather than stimulating it as intended. An empty seat is lost forever when a flight is operated. Seats cannot be stored for future sales as are manufactured goods in unregulated industries.

California appears to have borne the brunt of airline deregulation in terms of its intrastate air service.

California intrastate fares have doubled, on the average. In the San Francisco-Los Angeles market, which accounts for approximately 45 percent of the California intrastate passenger traffic, the fares increased 114 percent. Consumer prices rose only 29 percent during this period. (24) A House Appropriations Committee staff report found that leisure travelers may be paying more now for discounted tickets than they would have paid for full-fare services before deregulation. Even more alarming is the finding that businessmen and non-discretionary travelers are paying about twice as much for coach service as when the deregulation act was passed in 1978. The report concludes that the "unexpected losers" are the medium-sized cities, and that the "expected benefits" of deregulation (low fare structures) have not materialized. (25) The market place has reacted true to form, as in other non-regulated industries: destructively low prices where there is an over-abundance of competition and excessive prices where there is little competition.

Site discrimination

The public is alarmed about the discrimination taking place in fares between most city pairs. Communities and cities are being bypassed because of illogical fare structures. National conventions will soon be limited to Florida and California at the expense of less accessible places such as Phoenix, New Orleans, Seattle, Sun Valley, St. Louis, Hilton Head Island, etc. National meeting planners will select meeting sites where they can obtain the lowest air fares from every area in the country or be faced with severely reduced attendance.

It makes little sense to a businessman in Seattle to be able to fly to Orlando, Florida and return for $326, but be required to pay $437 to Phoenix and return. Nor will southern businessmen tolerate special group fares to Los Angeles to attend a convention when their northern competitors can fly a much greater distance to the same convention for approximately 40% less. (26)

To transportation professionals, this practice violates one of the basic principles upon which our national transportation network was established: the "long-and-

short-haul clause". Under this concept, all communities were assured comparable rates and fares related to distance. Generally speaking, firms located closer to markets would be assured of lower rates than firms located at greater distances from the same markets.

The principle has been discarded by the marketplace theory. Congress has reversed its statutory commitment to mid-American businessmen, travelers and communities for reasonable, non-discriminatory service and prices.

The only beneficiaries of airline deregulation thus far have been the bargain-fare travelers who are reaping windfall benefits from the unbridled fare wars between new entrants and major airlines. As the travelling public will soon learn, low prices are not necessarily in their best interest. Profits are necessary for fleet modernization plans and for strict maintenance and servicing programs. Below cost fares and rates must be offset by excessively high prices on other routes and on other types of traffic.

Individual travelers have no interest in the maintenance of a national transportation network or in the short-term or long-term effects of these fare wars. Their sole concern is departing and arriving at the scheduled time and in paying the cheapest fare available.

Most airline executive have little interest in the maintenance of a strong, viable airline system, as they are preoccupied with their own survival and profits. That leaves Congress as the sole protector of the public interest and the future strength and viability of the airline network.

Reactions to airline deregulation

At least one airline consultant envisions a great danger that deregulation will produce less competition in the long term—the opposite of its proponents' intent. (27) Another aviation consultant and former TWA and American Airline executive observed with respect to the suggestion that airspace slots be auctioned to the highest bidder, that this approach would create a bidding war and inflate airline costs, "without satisfying the public-interest requirements of a balanced air service". (28) More and more analysts and transportation users and apparently beginning to be concerned with the public interest. (29)

The domestic crisis has reached such major proportions that Senator Howard Cannon, ranking minority member of the Senate Commerce, Science and Transportation Committee was concerned enough to call for a summit meeting of airline officials and government officials to find ways to assist the airlines during this difficult economic period. (30) This call for relief once again confirms the fundamental truth that the airline industry is affected with the public interest and, therefore, can not be permitted to manipulate prices in a manner which will destroy our vital transportation network.

The solution lies not in granting "one-time-only" immunity to the participants of such a summit conference to permit them to "discuss and exchange ideas on the most effective policies and means to achieve rational, cost-related, nondiscriminatory fare structures in the newly deregulated environment." The marketplace is supposed to determine such fares through the application of the economists' textbook theories. Any interference by the government at this stage would be an admission that the marketplace is not a desirable regulator of entry and prices in public utilitytype industries. The blame can not, and should not, be placed on the recession, fuel prices or the PATCO strike. The financial crisis faced by the airline industry would not have occurred, or would not have been so severe, if reasonable regulatory powers had been applied to prevent excessive competition and predatory pricing at a time when traffic levels and profits were depressed to unprecedented levels.

The public interest can only be protected by an immediate return to reasonable government regulation of the service and pricing practices of airline management, and the restoration of the obligation to provide reasonable service to all regions of the nation at reasonable, cost-related prices.

Airline executives have begun to clamor for an end to the senseless fare-wars. Eastern's Chairman, Frank Borman, labeled them "absolutely irresponsible". World Airways petitioned the Board for emergency rule-making with regard to fare discounting on March 9, 1982. The facts it cited in support of its petition are illuminating:

1. In 1981, the domestic airlines accounting for over 90 percent of the industry's revenue suffered a net loss of $47 million dollars.

2. The industry is solvent, just when the reequipment cycle is to begin.

3. Fares in the long-haul, high-density markets are substantially below cost. For instance, the Standard Industry Fare Level (SIFL) set by the CAB for the NYC-Los

Angeles market is $346.46 one way. There were 24 fares below 50 percent of that level at the time the petition was filed.

4. World Airways' costs in this market are above $142 per passenger, and it claims it is the most cost-efficient carrier in the industry.

5. At these fares, the major airlines can not break even, even at a 100 percent load factor.

By its petition, World has concluded that the current irrational and self-destructive behavior is not the way the normal marketplace is predicted to work. The truth is that this is precisely the way the economists predicted it would work. Unbridled competition and marketplace pricing in transportation industries breed destructive competition and irreparable harm to the public.

Air Florida's Chairman, Eli Timoner, described the situation as "like lemmings throwing themselves off a cliff." (31)

Air Express International's President, Joseph N. Berg, called for a return of regulation, stating that "the undisciplined response to deregulation has created the instability we face today".

American's Vice President of Passenger Sales and Advertising, Robert W. Baker, described a competitor's give-away program as "irresponsible and ill-advised", but indicated that American cannot permit itself to be under-sold. (32)

Eastern's Senior Vice President-Marketing, Russel Ray, stated that "This business of assuming that there can be price leadership and deep discounts that will stay for more than a day is silly." (33)

Continental's Senior Vice President-Finance, Mr. Rawls, stated that "We would be better off just giving them $10 not to fly on Continental." (34)

TWA's Chairman, L. Edwin Smart, stated "Our airline unit is being compacted not only by the general recession and by higher interest costs, but also by the diversion of traffic to new entrants and the continued proliferation of deeply discounted fares in many markets." (35)

Pan American's Chairman, C. Edward Acker, stated "What Pan Am and the industry needed is a good 15 percent fare increase." (36)

Even the commuter airline industry is disenchanted with airline deregulation. Lou Davis, Editor of Commuter Air, wrote "In retrospect, deregulation, or 'open skies' is a great concept. Unfortunately, it doesn't work. Congress, government and commuters themselves must find ways and means of screening out the 'quick buck' artists." (37)

In its petition, World concludes that "The system has, in a word, broken down. The remaining question is what will be the intervening act that ends these fare wars—the insolvency of a substantial number of airlines or the constructive intervention of the Board?"

World then places the blame for this collapse on the Board's pre-deregulation actions by which it permitted a 50 percent–70 percent downward zone of reasonableness on August 25, 1978, based on its belief that such a change would not destroy the air transportation system. (38)

Obviously, the Board's marketplace experiments, codified in the Airline Deregulation Act of 1978, have proven to be a colossal failure.

World's petition, however, presents an "opportunity to temper theoretical economics with practical recognition that some industries do not behave in simple textbook fashion." (39)

Howard S. Freedland, an airline analyst, predicts that several major trunk carriers will be bankrupt in 1982 or soon after an economic recovery begins. He reasons that as soon as the market for used aircraft improves, banks will unload their airline debtors' fleets. He also says that deregulation has caused yields to decline 50 percent while the number of airlines flying the transcontinental routes has doubled. (40)

Henry Golightly of Golightly and Company International, an airline consultant, advocates a return to some kind of regulation to prevent bankrupticies. He warns that air deregulation could turn out to be a catastrophe unless the government takes steps to prevent more bankrupticies. (41)

But economists preach that bankruptcies care good in a free market because they eliminate the inefficient operators. This textbook theory overlooks the total cost of bankruptcies. Taxpayers eventually bear much of the cost through the loss of taxes paid by the bankrupt, the cost of unemployment and welfare benefits paid to discharged employees, etc. The public also pays in the form of higher interest rates necessitated by the losses suffered by the banks. Creditors lose and pass along their losses to consumers in the form of higher prices on their goods and services.

These considerations fail to account for the more important cost of bankruptcies—the human pain and suffering experienced by the officials, employees and stockhold-

ers of bankrupt companies. How long will the public condone an economic theory which encourages and fosters such tragedies?

In blaming all of these adverse results of deregulation on the recession, interest rates, PATCO and strikes, the deregulationists ignore one compelling factor. Under former CAB regulation, the Board could have prevented over-capacity rate wars, which unnecessarily dissipated carrier revenues on the high density and most profitable routes. The industry could have been kept solvent during these crises. Prescription of reasonable rates and fares in all markets would have prevented the discriminatory pricing policies which have completely distorted fares throughout the nation.

The question now is will Congress act to save our transportation system before deregulation runs its ill-fated course? Any move to control entry or pricing must be viewed as proof that the marketplace can not and should not be allowed to regulate public transportation industries.

Therefore, the danger is that the Board or Congress will merely apply stop-gap relief by setting minimum fares to preclude predatory rates and fares, as suggested by World Airways. Specifically, World suggests requiring the filing of any tariff on fares which are more than 50 percent below the SIFL level, accompanied by cost-justifications which would be reviewed by the Board and suspended if not cost-justified.

This solution, while it might mitigate the fare-wars, would not address the entry and exit problem, the discriminatory rate and fare levels, the long and short haul problem, the loss of reasonable service at small and medium-sized cities, or the unconscionable liability practices existing on cargo and baggage.

It is imperative to our national well-being that Congress review its deregulation policies with a great deal more statemanship than has been displayed thus far, and apply the remedies that will restore the airline industry to its former stature. Perhaps our legislators would benefit from a careful review of the conditions which led to federal control over railroads, motor carriers and eventually the airlines. (42) The conditions which led to regulation of other transportation modes are strikingly similar to the present crisis in our airline industry. (43)

In the process, Congress must also weigh the results of deregulation of the trucking, industry, where over-capacity and over-competition have similarly led to predatory pricing and scores of bankrupticies. (44) The first rumblings are being heard from Florida shippers and carriers concerning Florida's deregulation of intrastate trucking. (45) The deregulation of the railroads is having serious adverse affects on most rail shippers. (46)

Hope for an early reversal of Congress' deregulation policies was recently dimmed by enactment of legislation deregulating the bus industry. However, in voting against H.R. 3663, Senator Larry Pressler (R-S.D.) identified the fundamental error in the free entry and exit theory which will eventually spell its doom, stating:

"Our national transportation system was built on common carrier responsibility. If a common carrier . . . gets some very rich routes, it would also take the responsibility for some other routes that were not so profitable. That's how our whole westward transportation system developed. We abandoned that principle with deregulation."

Many fear that the deregulation of buslines will permit abandonment of much service at small communities throughout the nation. (47) The combined loss of air and bus service, following the loss of rail passenger and express service, will have a devastating effect on thousands of communities.

Once again, Congress has opened the door to freer entry and predatory pricing at a time when carrier traffic is depressed and revenues are declining. (48)

Conclusions

Airline deregulation has been a dismal failure for the great majority of the traveling public. Small cities and communities with inferior transportation services are losing business and are suffering irreparable harm. The airline industry is headed for bankruptcy as a result of self-destructive behavior permitted by the marketplace.

The obvious solution is to start anew with a sound regulatory policy, carefully administered by transportation-oriented experts instead of economists, and to reinstate air transportation as a public service requiring reasonable service and prices for all citizens and communities on a non-discriminatory basis.

The "grand experiment" with airline deregulation must be ended swiftly.

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(6) 14 C.F.R. 205.8.
(7) 49 C.F.R. 1043.
(8) EDR-438; DKT. No. 40366, Baggage Liability Rules, Federal Register, Volume 47, No. 24, February 4, 1982, p. 5235.
(9) P. Law, 96-448, October 14, 1980, 94 Stat. 1895.
(10) "Petitioner also alleges several problems with certain carrier circulars concerning liability for loss and damage. These allegations, however, are not sufficient to warrant any specific response on our part at this time. To the extent railroad tariffs or contractual items on TOFC/COFC service are in violation of 49 U.S.C. 11707, they are unenforceable as a matter of law. However, to the extent tariff or contractual terms are otherwise construed as offers limiting liability open to negotiation, they may be pursued . . . Petitioner neither identified any individual shipper who is objecting nor complained in the context of specific rates. To this extent, petitioner has presented, in effect, only examples of carrier offers limiting liability, which the carriers may pursue as discussed above. If concrete problems arise with respect to carrier loss and damage practices, we would, of course, accept petitions to amend in an appropriate manner the exemption given TOFC/COFC traffic." Improvement of TOFC/COFC Regulation, Ex Parte 230 (Sub-No. 5), June 17, 1981.
(11) In July, 1982, 15,081 passengers were involuntarily bumped, an increase of 48 per cent over the same month in 1981. As a result, the CAB re-imposed the double-payment provision of its denied boarding rules effective October 1, 1982. (CAB NEWS, October 5, 1982.) Under these rules, bumped passengers who cannot be rebooked on a flight that will get them to their destinations within two hours of their original scheduled arrival time are entitled to twice their one-way ticket, up to a maximum of $400.
(12) "Small Community Air Service Under the Airline Deregulation Act of 1978", Havens and Heymsfeld, Journal of Air-Law and Commerce, Volume 46, Spring 1981.
(13) Id. at pages 675 and 677.
(14) 49 U.S.C. 1302 (c).
(15) P. Law, 97-261, September 20, 1982, Bus Regulatory Reform Act of 1982.
(16) American Aviation Daily, February 26, 1982, p. 301.
(17) "Preliminary Analysis of Effect of Airline Deregulation of Intrastate Air Passenger Service in California", California P.U.C., Transportation Division, by Richard H. Brozosky, P.E.
(18) "Airline Deregulation in California", October 1981, California P.U.C., Transportation Division, by Richard H. Brozosky, P.E., Esq.
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(20) Senator Edward M. Kennedy (D-Mass.), "The Case For Airline Regulatory Reform", Ad Hoc Committee For Airline Regulatory Reform Seminar, June 28, 1977.
(21) "What's Best for Commuters?", Young, Commuter Air, November, 1981.
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(24) "Airline Deregulation in California", October 1981, California P.U.C., Transportation Division, by Richard H. Brozosky, P.E., Esq.
(25) American Aviation Daily, March 2 and 3, 1982.
(26) For instance, the recent ATA convention negotiated group fares to Los Angeles from various cities as follows: Atlanta—$546; Greensboro, NC—$456; Cleveland—$390; Chicago—$358; New York City—$318; Boston—$330; Philadelphia—$338; Hartford—$379.
(27) Juan O'Callahan, President, Transportation Analysis International, American Aviation Daily, January 29, 1982.
(28) "What Deregulation Has Done to Air Travel", Melvin A. Brenner, Letter in New York Times, October 22, 1981.

(29) "Antiregulation purists like Weidenbaum won't agree, but an untrammeled free market is not necessarily synonymous with the pubic interest". "Airline Deregulation Comes Back to Haunt" by Hobart Rowan, The Washington Post March 14, 1982.

(30) S. Res. 379, 97th Congress, 2d Session, April 27, 1982.

(31) Time, February 22, 1982.

(32) United Press International, February 26, 1982.

(33) American Aviation Daily, February 25, 1982.

(34) New York Times, February 22, 1981.

(35) Associated Press, January 26, 1982.

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(37) Commuter Air, November 1981.

(38) ". . . we do not believe the fear of destructive price competition is a realistic one in this industry", Reg. PS-80, August 25, 1978.

(39) "Recontrol Air Fares", Melvin A. Brenner, Consultant, in Letter to The New York Times, April 14, 1982.

(40) American Aviation Daily, February 17, 1982.

(41) Canadian Industrial Traffic League, Traffic Notes, December 18, 1980.

(42) For a comprehensive analysis of this subject, see "The Rise and Fall of The Civil Aeronautics Board—Opening Wide the Floodgates of Entry", Dr. Paul Stephen Dempsey, Transportation Law Journal, Volume II, November 1, 1979.

(43) "The government would be wise to regulate . . . before it gets in bad habits . . . just like existed in the bus and trucking business . . . where through cut-throat competition you could buy a ticket from Chicago to Detroit for as low as a dollar; and just like the practices existing in the railroads before they were regulated . . . They will not happen if you set up a proper minimum regulation through the enactment of . . . legislation . . . requiring the issuing (sic) of certificates of convenience and necessity. We have already lost about $60,000,000 of the $120,000,000 that has been invested. We cannot go on losing money; we cannot ask people to put money into this industry . . . when their investment can be taken away from them by some unregulated and irresponsible competing company . . . Not many people are willing to invest capital in the airline business today . . . unless there is some proper protection against . . . irresponsible companies which might institute service with second-hand planes and cut prices right out from under legitmate operators." Col. Edgar S. Gorrell, President, Air Transport Association, Testimony before House Committee on Interstate and Foreign Commerce, 75th Cong. 1st Session 53 (1937) on H.R. 5234 and H.R. 4642.

Similarly, the Senate Committee on Interstate Commerce expressed its concern as follows: "In recent years, there has been an extraordinary growth of transportation by air. The airlines . . . are engaged in intensive competition with each other and with . . . other carriers. This competition is being carried to an extreme which tends to undermine the financial stability of the carriers and jeopardize the maintenance of transportation facilities and service appropriate to the needs of commerce and required in the public interest and the national defense. Aviation in America today, under the present laws, proves unsatisfactory to investors, labor, shippers, and carriers themselves." Senate Committee on Interstate Commerce, Air Transport Act, 1937, S. Rep. No. 686, 75th Cong., 1st Session.

(44) Since deregulation of the motor carrier industry, 234 trucking companies have filed for bankruptcy, have gone out of business or discontinued their general commodity operations. In the first quarter of 1982, general commodity carriers lost $2 for every $100 of revenue earned. Source: American Trucking Association.

(45) A consensus of experts testifying before the Transportation Committee of the Council of State Governments was that deregulation in Florida caused more problems than it solved, and has resulted in poorer service and chaotic scheduling of shipments. Traffic World, October 4, 1982.

(46) "What All Businessmen Sould Know About Railroad Deregulation", Harold E. Spencer, Esq., Traffic World, February 8, 1982 and April 26, 1982. and see, "Clear Track for Deregulation—American Railroads, 1970-1980", William E. Thoms, Transportation Law Journal, Volume XIII, Nov. 2, 1982.

(47) Florida's Department of Agriculture and Consumer Services has received many complaints about the discontinuance of bus service at numerous communities as a result of deregulation. Traffic World, October 4, 1982.

(48) The ICC reports that second quarter operations for the major buslines show a 2.8 percent decline in revenues and a 5.1 percent decline in passengers, resulting in a 37.4 percent decline in net income.

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Appendix A

DOMESTIC AIRLINES' TIME LIMITS FOR FILING LOSS AND DAMAGE AND OVERCHARGE CLAIMS

[As of Jan. 1, 1982]

Airline codes [1]	Notice of concealed loss and damage	Loss, damage, and delay		Overcharge	
		Claims	Suits	Claims	Suits
General rules section:					
AC	15 days from delivery.	120 days	2 yr from disallowance.	180 days	180 days.
BN	do	270 days	do	270 days	2 yr from delivery plus 6 mo from disallowance.
AQ, CP, ND, PW, QB, RV.	do	do	do	2 yr	Do.
CO, CQ, HY, IU, JC.	do	9 mo and 9 days	do	do	Do.
RC	do	do	do	None	Do.
OC, PS	([2])	do	do	2 yr	Do.
FL	15 days from delivery.	120 days	do	1 yr	Do.
FY	do	270 days	do	2 yr	Do.
PI	do	9 mo and 9 days	do	9 mo and 9 days	Do.
NW	do	do	do	do	Do.
WA	do	do	do	do	180 days.
All others in rule G60.	do	do	do	2 yr	2 yr from delivery plus 6 mo from disallowance.
Individual rules section: [3]					
AA	do	270 days	2 yr from disallowance.	2 yr	2 yr from delivery plus 6 mo from disallowance
DL	do	9 mo and 9 days	do	9 mo and 9 days	Do.
EA	do	180 days except P.R. and Virgin Islands (120 days).	do	do	Do.
FT	do	9 mo and 9 days	do	2 yr	Do.
TW	do	do	1 yr from disallowance.	1 yr	1 yr from delivery plus 6 months from disallowance.
VK	15 days from delivery—and may be by phone and confirmed in writing.	270 days	do	do	1 yr from disallowance.

[1] See list following for names.
[2] "Notice of intent" to file within 30 days, nondelivery within 90 days, except concealed—15 days. Compiled by SNFCC, 120 Main St., Hunt., N.Y. 11743—The material contained herein may not be reproduced without specific permission in writing.
[3] The author assumes no responsibility for the accuracy of the following information due to the absence of official tariffs filed with a government agency. Amounts and conditions stated herein are subject to change without notice to the public.

Note: All times measured from date of acceptance of shipment by carrier, unless otherwise indicated.

Appendix B

AIRLINE LIABILITY LIMITS AND EXCESS VALUE CHARGES

[As of Jan. 1, 1982]

Air carrier	Liability limit [1]	Excess value charge per $100 (cents) [2]
AA	$9.07 per lb per piece	40
AC	(Within Canada) $1.10 per kilo (between U.S. & Canada) ½ of declared value over U.S. $20 per kilo or $9.07 per lb (min $20).	15
AK	$9.07 per lb per piece	40
AL	$9.07 per lb per piece	40
AQ	$9.07 per lb per piece	10
AS	50 cents per lb per piece	25
BF	50 cents per lb per piece	40
BN	50 cents per lb	40
CO	$9.07 per lb per piece	40
CP:		
Within Canada	$1.10 per kilo	15
Between United States and Canada	½ of declared value over U.S. $20 per kilo or $9.07 per lb (minimum $20).	15
DL	50 cents per lb per shipment	40
DP	50 cents per lb per piece	40
DU	50 cents per lb	25
EA	50 cents per lb	40
FL	50 cents per lb per piece	40
FT	$9.07 per lb per piece	40
FY	$9.07 per lb per piece	10
GQ	50 cents per lb per piece	40
GW	50 cents per lb per piece	40
HY	$9.07 per lb per piece	40
iU	$9.07 per lb per piece	40
JC	50 cents per lb per piece	40
MJ	50 cents per lb per piece	40
ND:		
Within Canada	$1.10 per kilo	[3]
Between United States and Canada	$1.10 per kilo	[4]
NW	50 cents per lb	15
OC	50 cents per lb	40
OZ	50 cents per lb per piece	40
PA	50 cents per lb (No right to declare higher value on perishables)	40
PI	$9.07 per lb per piece	40
PS	50 cents per lb	40
PW:		
Within Canada	$1.10 per kilo	15
Between United States and Canada	$1.10 per kilo	10
QB	$1.00 per kilo	40
RC	50 cents per lb	40
RV	$9.07 per lb per piece	10
TI	50 cents per lb per piece	40
TW	$9.07 per lb per piece	40
UA	50 cents per lb	25
VK	50 cents per lb	15
WA	50 cents per lb per piece	40
WC	50 cents per lb per piece	25
ZV	50 cents per lb per piece	40
ZW	50 cents per lb per piece	40

[1] Per pound, minimum $50 per shipment, unless otherwise indicated.
[2] Applies only to declared value in excess of liability limit, unless otherwise indicated.
[3] 20 cents per $100 of declared value.
[4] 20 cents per $100 of declared value in excess of $1.10 per kilo.

Note: The author assumes no responsibility for the accuracy of the following information due to the absence of official tariffs filed with a government agency. Amounts and conditions stated herein are subject to change without notice to the public.

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STATEMENT OF EDWARD A. DEEDS, CHAIRMAN OF THE BOARD, ANA, LTD., DOING BUSINESS AS AIR NORTH

Air North is a Part 121 air carrier based in Burlington, Vermont, and currently providing service to Burlington; Boston, Massachusetts; Washington, D.C.; and New York City, Elmira, Poughkeepsie, Binghamton and White Plains, New York. While some carriers, and especially new entrants, have benefitted from aviation deregulation, Air North's participation in the Deregulation Act's Essential Air Service Program was a financial disaster for our airline. In the two years we operated subsidized service to the northern New York communities of Plattsburg, Massena, Watertown, Saranac Lake/Lake Placid and Odgensburg, we lost more than our total net worth. Moreover, the losses we sustained dangerously undermined our previously strong financial position. Our financial margins are now so slim that even slight unfavorable changes in the economy, or in the carrier's traffic, fare or expense levels could well force us to discontinue all scheduled operations.

The communities we served have suffered as well. Section 419 was added to the Deregulation Act to ensure that small communities would have access to the nation's air transportation system during the 10 year transition from regulation to deregulation. Because Air North experienced heavy losses from the very beginning of Essential Air Service and was unable to obtain any relief from the Board, we were forced to reduce the service we had planned to offer. Ultimately we had no alternative but to suspend operations entirely at the subsidized points. Those communities are now receiving 50 percent less air seat capacity. Such service reductions may seriously impair the ability of small communities to sustain profitable—and therefore any—air service when the Essential Air Service Program ends in 1988.

Air North became involved in the Essential Air Service Program immediately after the passage of the Airline Deregulation Act, when Allegheny Airlines filed with the C.A.B. to terminate its legal obligation to provide service to five northern New York communities. Air North submitted its proposal to provide air service under Section 419 of the newly-enacted Deregulation legislation. Based upon its then 10 years of experience in serving these same New York communities as an Allegheny Commuter, Air North calculated that it would require an annual subsidy rate of approximately $1.4 million. The C.A.B. rejected this amount as "unreasonable" and conditioned Air North's award of the routes upon its acceptance of a far lower subsidy rate: $727,000 per year.

Air North's application was the first to be decided by the C.A.B. under the Essential Air Service Program, which was designed to replace the Section 406 subsidy program at a much lower cost. There were no regulations or procedures in effect at that time to guide either the carrier or the C.A.B. in establishing a fair subsidy rate for providing Essential Air Service. There was thus an understandable tendency to operate the Program as a "low bid" system, even though the legislative history of the Deregulation Act makes it clear that air service to small communities is not to be awarded solely to the lowest bidder.

Moreover, the unfamiliarity of both the Board and our company with the new Program caused protracted delays in the proceedings of the Board. Our initial selection procedures took 14 months. And, when staggering losses required us to terminate service on these routes, delays in seeking and selecting a replacement carrier forced us to fly these routes at the same low subsidy rate for a full seven months after our ninety-day notice of termination period had expired.

As a result of this lack of established policies, as well as the C.A.B.'s and Air North's lack of experience with the new subsidy program, a number of ad hoc procedures were used in Air North's case that were changed or modified for carriers subsequently selected to participate in the Program.

In Air North's case, outdated costs and fares were used to calculate Air North's subsidy level. As both the Board and the carriers gained experience with the Essential Air Service Program, new formulas and procedures were adopted so that carriers' subsidies were based upon the most current cost data available to the Board. The experimental procedures used at the start of the Essential Air Service Program were particularly injurious to Air North because costs in general and fuel costs in particular were rising rapidly at that time.

Air North's low subsidy rate was fixed for two years with no provision for adjustment for extraordinary factors beyond the carrier's control. Traffic on the routes

declined drastically—40–50 percent—as a result of the proximity of the area to Montreal and its much lower fares, and to the generally negative economic climate of the area. These traffic declines further exacerbated Air North's losses. However, such traffic declines are not unique to Air North's situation for, as the recent G.A.O. Report on the Essential Air Service Program notes, the number of passengers at small communities has decreased 50 percent since deregulation. We believe that, if this Program is to be effective, the Board should exercise its discretion to establish self-adjusting rates to counter the effect of such unforeseen changes upon carrier revenues. These rates would protect carriers from unforeseeable negative events, as well as the Board and the taxpayer from unforeseen position events.

The administrative procedures used in the Air North "test case" under the Essential Air Service Program caused us great financial harm. We lost $2.5 million—more than our total net worth—from February 1980–February 1982, as a direct result of serving as an Essential Air Service carrier at subsidy levels which were set far too low and for far too long.

The magnitude of these losses forced Air North to withdraw from serving the northern New York communities in April of 1982. We have still not recovered financially. Air North's net worth has declined from a positive $2,079,044 at the end of fiscal year 1979, just before the start of our Essential Air Service operations, to a negative $995,861 at the end of fiscal year 1982. Although Air North began to show a slight gross profit in the first quarter of 1983, we were forced to borrow so heavily to sustain operations during the 1980–82 period that we are still experiencing a significant negative cash flow.

Such devastating financial damage to a carrier wishing to provide air service to small communities is clearly not the intended result of aviation deregulation. If such service is to be continued, carriers participating in the program must be treated equitably and compensated farily.

To summarize, administration of the Essential Air Service Program has improved since we participated in it. However, some problems still remain. It is extremely important, both for the carriers and the communities involved in the Essential Air Service Program, that participating carriers be allowed to earn an adequate rate of return. While the cost of service should be an important consideration, carriers should be selected and compensated based upon what would best benefit the public interest as a whole. Once a carrier has been selected, selfadjusting subsidy rates should be set in order to assure fairness in the event of unforeseen circumstances. The program should strive for eventual freedom from subsidy by encouraging the development of traffic at each community, rather than focusing entirely on the maintenance of service. If carriers do not earn adequate rates of return, or are forced to continue to perform at unrealistically low subsidies in the face of significantly changed circumstances, or if lengthy administrative delays continue to characterize designation and termination proceedings, carrier will withdraw from the Essential Air Service Program. This is an undesirable result from all points of view. Small communities will lose air service. Those carriers which do participate will risk severe fianancial losses. And the C.A.B. itself will eventually be required to pay much higher subsidy levels to attract replacement carriers to serve the small community market.

This outcome would frustrate Congress' long-term goals for the essential Air Service Program: improving air service to small communities and holding subsidy costs borne by the taxpayers to reasonable levels. A prime example is the experience of Air North's successor in the Essential Air Service Program on the northern New York routes. After our heavy losses forced us to stop service on these routes, the C.A.B. awarded Clinton over two and one-half times the annual subsidy we received for providing 50 percent less seat capacity to the same communities.

In order for airline deregulation not to have an adverse impact upon service to small communities, it is crucial that the Essential Air Service Program be administered fairly and rationally. While a number of the guidelines that caused Air North to suffer such huge losses have since been altered, Congress should encourage the C.A.B. to select carriers for subsidy expeditiously, and then provide them with greater financial protection and flexibility.

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